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By Mr. A. Keyan (Chairman  
of the Committee) on Tuesday,  
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KENYA NATIONAL ASSEMBLY  
Tenth Parliament – Fourth Session

REPORT OF THE  
PARLIAMENTARY SELECT COMMITTEE ON THE  
DECLINE OF THE KENYA SHILLING AGAINST  
FOREIGN CURRENCIES

Clerk's Chambers  
Parliament Buildings  
NAIROBI

February, 2012

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## PREFACE

Mr. Speaker Sir,

1.1 On Wednesday, November 16<sup>th</sup> 2011, following a Motion in the House by the Hon Adan Keynan, M.P. The House resolved to establish a Parliamentary Select Committee on the decline of the Kenya Shilling against other currencies.

1.2 Mandate of the Select Committee –

1.2.1 The mandate of the Select Committee as per the resolution was:-

- i) To comprehensively investigate and inquire into the causes of drastic and steady decline of the Kenya shilling against foreign currencies;
- ii) To make recommendations on the way forward.

1.3 Consequently, the Committee was required to submit a report to the House within 60 days. The Committee subsequently sought extension for thirty days which was graciously granted by the House.

1.4 **Motion Setting Up the Select Committee and its Composition**

THAT, aware that Kenya is the East Africa's biggest economy and regional economic hub, noting that Kenya is facing a spike in inflation and her currency has plummeted to its weakest level and is now recorded as the continent's worst performer this year despite being fairly stable for the last four decades, concerned that the Central Bank of Kenya has maintained a "*watch and see attitude*" and has publicly admitted that it could not control the currency slip citing that some commercial Banks are hoarding foreign currencies and has asserted that the problem may persist for another six months, considering that the Task Force established by the Rt. Hon. Prime Minister to help

stabilize the shilling, the efforts by the Monetary Policy Committee and the interventions by Treasury have not succeeded in addressing the situation, aware that this depreciation trend has made many Kenyans and foreign investors incur massive losses and the cost of transacting business unduly expensive, this House resolves to constitute a Select Committee to comprehensively investigate the cause(s) of the drastic and steady decline of the Kenya Shilling against the foreign currencies and make recommendations on the way forward and that the Committee shall comprise the following and shall table its report within sixty days of its appointment.

- 1) Hon. Adan Keynan, M.P. – Chairperson
- 2) Hon. Rachel Sherbet, M.P. – Vice Chairperson
- 3) Hon. Shakeel Shabbir, M.P.
- 4) Hon. Charles Kilonzo, M.P.
- 5) Hon. Benjamin Langat, M.P.
- 6) Hon. Peter Kiilu, M.P.
- 7) Hon. Moses Lesonet, M.P.
- 8) Hon. Emilio Kathuri, M.P.
- 9) Hon. Benedict Gunda, M.P.
- 10) Hon. Shakila Abdalla, M.P.
- 11) Hon. Ntoitha M'Mithiaru, M.P.
- 12) Hon. Martin Ogindo, M.P.
- 13) Hon. Yusuf Chanzu, M.P.
- 14) Hon. (Dr.) Erastus Mureithi, M.P.
- 15) Hon. Abdul Bahari, M.P.
- 16) Hon. Adan Bare Duale, M.P.
- 17) Hon. Jakoyo Midiwo, M. P.
- 18) Hon. Chris Okemo, M. P.
- 19) Hon. (Prof.) Philip Kaloki, M. P.

## 1.5 Meetings

1.5.1 The committee set out to achieve its mandate by holding a series of meetings both internal and with stakeholders comprising of institutions, individuals and experts in the industry. In total, the Committee convened twenty seven (27) sittings with the relevant Government agents and other stakeholders in the financial sector.

## 1.6 Submissions to the Committee

1.6.1 The Select Committee received both oral and written submissions from 30 stakeholders in the industry. These comprised of the following:-

### (i) Government Agencies

- Central Bank of Kenya
- Ministry of Finance
- Parliamentary Budget Office, Kenya National Assembly
- Kenya Revenue Authority
- Taskforce on the Decline of the Kenya Shilling (Office of the Prime Minister)
- Energy Regulatory Commission
- Capital Markets Authority
- Kenya Tourism Board
- Kenya Ports Authority
- Kenya Institute for Public Policy Research and Analysis (KIPPRA)
- Export Promotion Council (EPC)
- Kenya Investment Authority (KenInvest)
- School of Economics, University of Nairobi

### (ii) Commercial Banks

- Equity Bank Limited
- Kenya Commercial Bank Limited
- Cooperative Bank of Kenya Limited
- Citibank Limited

- Family Bank Limited
- Barclays Bank of Kenya Limited
- CFC Stanbic Bank
- Housing Finance Company Kenya Limited
- Standard Chartered Bank Ltd
- Kenya Bankers Association

(iii) **Economic Experts**

- Dr. David Ndii - Economist
- Mr. Micah Cheserem – Former Governor of the CBK
- Dr. Thomas Kibua - Former Deputy Governor of the CBK

(iv) **Other Stakeholders**

- Foreign Exchange Dealers Association
- Kenya Private Sector Alliance (KEPSA)
- Consumers Federation of Kenya
- Institute of Economic Affairs (IEA)

**Note:** National Security and Intelligence Service (NSIS) and Commercial Bank of Africa were sent letters of invitation but did not appear.

## SUMMARY OF FINDINGS

2.1 The Committee received a range of the causes of the fall of the Kenya shilling which the committee divides into economic, human and institutional failures. The economic causes such as the wide current account deficit, Euro crisis, large import bill of non-essential commodities, the Arab Spring, are still in place even after the shilling recovered its value in December 2011. The Committee therefore zeroed on institutional and human failures. These factors include policy indecisiveness and inaction of the CBK which has capacity to stop the slide, speculative activities of some Banks and individuals, and inaction by the Ministry of Finance which also has powers in law to intervene if CBK cannot act. These factors are outlined as follows:

### **2.1.1 Policy indecisiveness and inaction of the Central Bank of Kenya (CBK)**

- The Committee finds the following acts as directly linked to the slide of the shilling:

- (i) Creating opportunities for arbitrage
- (ii) Failure to detect and arrest speculative activities
- (iii) Unclear Communication to financial markets
- (iv) Ineffectiveness of the Monetary Policy Committee (MPC)
- (v) Inadequate policy responses
- (vi) Belated intervention by the CBK

### **2.1.2 Governor of the CBK - The Committee finds that the CBK Governor:**

- (i) Did not react in good time to the problem of sharp decline of the shilling which triggered a panic and fertile ground for hoarding in foreign currencies and speculation.
- (ii) Kept CBK Discount Window interest rates below the interbank rate and Treasury bill rates that encouraged the commercial Banks to by-pass the interbank market to borrow from the Discount Window.
- (iii) Allowed communication breakdown between the CBK and the Banks.
- (iv) The Governor played down the gravity of the problem to the extent that in various instances and forums, he was quoted saying that he would not intervene in the foreign exchange market.
- (v) Being less candid enough with information to Kenyans and even to this Select Committee. For instance, the Governor claimed publicly that some Banks, which he refused to name, were responsible for arbitrage and hoarding of foreign currencies.
- (vi) Overseeing the rise of the CBR rate to 18%, hence occasioning Kenyans heavy interest rate payments.

- (vii) Is squarely responsible for creating the opportunity for Banks and individuals to make quick money through speculation and hoarding.
- (viii) His announcement and release of CBK circular to bypass the Banking system and deal directly with buyers or sellers of foreign exchange, although reversed, was in complete disregard of the financial structures and could have opened opportunities for rationing of foreign exchange, occasioned parallel markets to thrive.

**2.1.3 Arbitrage by commercial Banks** - Various financial players, including commercial Banks participated in arbitrage. Although this is not illegal and is a common business practice, the Committee observed that Banks exploited loopholes in the financial market to borrow funds from the CBK through the Discount Window and used the funds to profit from foreign exchange trading or to buy Government securities.

**2.1.4 Commercial Banks with increased foreign exchange trading activity** - Three Banks namely; CFC Stanbic Bank, Standard Chartered Bank, and Citibank were reported to have had increased foreign exchange trading activity. CBK wrote to them seeking explanation and clarification.

**2.1.5 Suspension of specific financial institutions from participating in the interbank market or foreign exchange market** - the Governor reported that CFC Stanbic Bank had flouted the guidelines issued on October 13, 2011 regarding the tenor of foreign currency swaps. The Bank was suspended from participating in the swap market for 30 days and was also penalized Ksh. 1 million in line with the Banking Act (Section 2(a) of Legislation No. 77 of 1999: The Banking (Penalties) (Amendment) Regulations 1999).

- 2.1.6 Commercial Bank Foreign Exchanging holdings** - The committee finds that 12 major Banks held 87.7% of total foreign assets by September 2011.
- 2.1.7 Conflict of Interest** –The Committee finds that top management and board members in some Banking institutions hold board positions in key public policy organs which are tasked with major development projects in the country. This is a source of disaffection and suspicion among Banks which feel undue advantage is gained by such Bank executives. For instance, the CEO of Equity Bank chairs the Vision 2030 board which in the Committee’s opinion and that of other Banking institutions provides undue advantage on present and future information about inflow of funds towards infrastructure development. Similarly, the chairman of Equity Bank chairs the National Oil Corporation.
- 2.1.8 Kenya Bankers Association** – The Committee found that the interaction between the regulator and KBA, which is an interest group for profit seeking Banks, was inappropriate in free markets. This opens up opportunities for collusion, arbitrage and speculation in foreign currencies.
- 2.1.9 Inaction by the Ministry of Finance** – The ministry of finance failed to exercise the provisions of the Central Bank Act (Cap 491 section 4c) and take a proactive role to tame the decline of the shilling.
- 2.1.10 Poor working relationship** existed between the CBK and commercial Banks.
- 2.1.11 Failure** by the fiscal and the monetary policy organs of the Government to take timely corrective measures to arrest the slide of the shilling against major currencies.

**2.1.12 Capital Flight** - The country suffered capital flight during the period when the Kenya shilling was depreciating. The uncertainties about the unpredictable exchange rate of the Kenya shilling fuelled negative expectations about the economy and key macroeconomic variables.

**2.1.13 Global economic crisis**– The Committee finds factors external to the domestic economy may have played a role in the decline of the shilling. These include Euro zone debt crisis, US debt crisis, and Political events in the Middle East and North Africa. However, since these conditions still persist, the committee considers them not to have been the main causes for the drastic depreciation of the shilling.

## SUMMARY OF RECOMMENDATIONS

3.1 On the basis of the above findings, the Committee has drawn a range of recommendations which will ensure that future crisis such as the sharp depreciation of the shilling is not replicated. The Committees' recommendations span both economic and institutional changes as follows:

### 3.1.1 Monetary Policy

- (i) **Governor of the CBK** –The Committee finds the Governor's conduct and behavior incompatible with the holder of the office of Governor of the Central Bank of Kenya and therefore recommend:
- The Governor takes responsibility for allowing the sharp decline of the shilling.
  - The Governor steps aside to pave way for thorough investigations
  - That the President should constitute a Tribunal to investigate the Governor's conduct, incapability and incompetence to perform the functions of the office as per the provisions of the CBK Act Cap 491 section 14 (2)(f) and 14(3).

### 3.1.3 Supervisory Oversight of Financial Institutions

- (i) **CBK should develop tools to efficiently monitor financial markets**
  - Particularly find tools to quickly deal with the adverse effects of innovations in foreign exchange trades such as the Electronic Brokerage System, foreign exchange swaps and carry trades.
- (ii) That the CBK should increase the speed and responsiveness to market developments to deal with rapidly changing financial market behavior.
- (iii) **Independent forensic audit - That;**
  - Ethics and Anti-Corruption Commission and the Auditor General's office to carry out an independent forensic audit on the operations and transactions of the Discount Window and foreign exchange trading of twelve Banks which had the largest foreign exchange holdings by September 2011.
  - The CMA to conduct a comprehensive investigation of the NSE to determine suspect capital inflows and outflows from the Bourse and report to parliament within 90 days from the date of adoption of this report by the House.
- (iv) **Review of Internal Processes** - That CBK carries out an internal audit of what went wrong in monetary operations and Bank supervision with a view to rectifying the problem.
- (v) **Banking Penalties Regulations** –Amendments be made to the CBK Act and the Banking Act in order to revise and enhance the penalties which may be imposed for breach of CBK Regulations to levels proportionate of the value to the Bank of the malpractice at that particular time. Since the current amount of penalty, Ksh. 1 million is too lenient, the Committee recommends a more deterrent penalty of 50% of the amount involved or Ksh. 20 million whichever is greater (regulation 2 of the Banking (penalties) Regulations, 1999).

### 3.1.4 Fiscal Policy

- (i) Reduction of the current account deficit through exports promotion.
- (ii) **Placing tariffs and non-tariff barriers on non-essential imports** - the Ministry of Finance should explore ways through the regional trading arrangements to increase tariffs on non-essential commodities so as to reduce the import bill.
- (iii) **Exercise of powers provided under the law** – That the Ministry of Finance should not hesitate to take policy measures if the CBK grossly deviates from its monetary policy statement.
- (iv) **Strong Macroeconomic Fundamentals** - The Committee finds the CBK and the Treasury lacking in strong Macroeconomic fundamentals in the form of policy. Both institutions appear to have been overenthusiastic about economic stimulus. The CBK also maintained the low interest rate regime for far too long. The CBK should therefore maintain a coherent monetary policy at all times with a focus on price stability.
- (v) **Coordination between the Monetary and Fiscal Policy Institutions** - The Committee recommends effective policy coordination between the fiscal and monetary authorities/agencies.

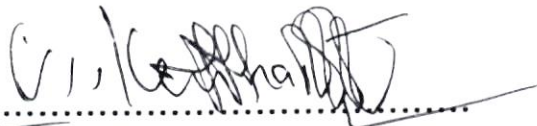
7.3.6 Finally, the current interest rates of slightly over 30% charged by banks are unrealistic, harmful and untenable. Therefore, the Government, CBK and financial market players should put in place deliberate mechanisms to reduce the interest rate to affordable rates within three (3) months of adoption of this report by the House.

## ACKNOWLEDGEMENT

Mr. Speaker Sir,

- 4.1 The foregoing is a summary of the Select Committee report on the drastic decline of the Kenya Shilling against other Foreign Currencies. The Committee Observations, Findings and Recommendations are the outcome of the insightful submissions made to the Committee by various stakeholders in the Financial Markets, Government Agencies and distinguished experts in the economic discipline. I take this opportunity to thank them most sincerely.
- 4.2 May I, on behalf of the Committee extend our gratitude for the invaluable support accorded to the Committee by the Parliamentary Service Commission and the Office of the Clerk of the National Assembly towards executing the Committee's mandate. Further, I wish to assure this House that the observations and findings contained in the report were unanimously agreed upon by Members of the Select Committee.
- 4.3 Finally, Mr. Speaker, It is my pleasant duty and privilege, on behalf of the Select Committee on the decline of the Kenya Shilling against foreign currencies, to present this report to the House for adoption pursuant to Standing Order 181.

SIGNED.....



HON. ADAN KEYNAN, M.P.  
CHAIRPERSON

DATE: .....

11/2/2012.....

The Report was countersigned by the following Members of the Committee:-

- 1) Hon. Adan Keynan, M.P. – Chairperson
- 2) Hon. Rachel Shebesh, M.P. – Vice Chairperson
- 3) Hon. Benjamin Langat, M.P.
- 4) Hon. Peter Kiilu, M.P.
- 5) Hon. Moses Lesonet, M.P.
- 6) Hon. Emilio Kathuri, M.P.
- 7) Hon. Shakila Abdalla, M.P.
- 8) Hon. Ntoitha M'Mithiaru, M.P.
- 9) Hon. Martin Ogindo, M.P.
- 10) Hon. Yusuf Chanzu, M.P.
- 11) Hon. (Dr.) Erastus Mureithi, M.P.
- 12) Hon. Adan Bare Duale, M.P.
- 13) Hon. Jakoyo Midiwo, M. P.

- (ii) **Productive communication between CBK and financial market players** - the Committee recommends that CBK should design a framework of engaging with foreign exchange market players within the confines of the financial market laws and regulations.
- (iii) **Coherence of monetary policy** - The Committee found that the CBK may have been overenthusiastic about economic stimulus and also maintained the low interest rate regime for far too long, and therefore recommends that the CBK should maintain a coherent monetary policy at all times with a focus on price stability.
- (iv) **Early warning mechanism** - CBK should put in place thresholds or trigger values for which the foreign exchange should fluctuate in times of extreme crisis and at which the CBK would move in to restore stability.
- (v) **Strengthen reserve position of the CBK** - That the Government and CBK should take adequate steps to boost the reserve position to at least the 4 months of import cover to strengthen its ability to respond to market volatility.
- (vi) **Enforcement of the In-Duplum Rule** – Section 44A of the Banking Act needs to be enforced and further amended to apply to all loans – both performing and non-performing.

### 3.1.2 Legal Amendments

3.1.2.1 Suggested amendments to the CBK Act should target, but are not restricted, to the following:

- (i) **Position of Chair and Deputy Chair of the CBK Board**– Amendment to the Central Bank Act (CAP 491 section 11 (1)(a)(b)) to provide that the CBK Governor and the Deputy Governor

cannot chair the Board of Directors of CBK which is expected to review his performance in achieving the CBK core mandates.

- (ii) **Appointment of the Governor and Deputy Governor** - That the CBK Governor and Deputy Governor be recruited through a transparent and competitive process.
- (iii) **Oversight over CBK**–Introduction of an amendment to the CBK Act to provide that the CBK Governor appears on a quarterly basis before a relevant Parliamentary Committee of the National Assembly to expound on monetary policy and other actions related to the discharge of the CBK core mandate of price stability and financial stability.
- (iv) **Autonomy of the CBK** – Strengthen the autonomy of the two arms of CBK namely, the Bank supervision/financial markets on one hand and monetary policy arm on the other.
- (v) **Sanctions** - Introduction of amendment to the CBK Act to provide for punitive sanctions on the Management of the Central Bank for gross failure in attainment of important monetary policy objectives or failure which occasions the country huge losses.
- (vi) **The Monetary Policy Committee** – Amendment to section 4(d) of the CBK Act to provide for an extra member to the MPC of a CBK staff responsible for Bank supervision.
- (vii) **Conflict of interest**– That senior managers and board members of Banks should not hold positions in Government policy organs or Government commissions with direct impact on financial and monetary policies.

## CHAPTER ONE

### 1.0 INTRODUCTION

- 1.1 The Kenya shilling had been stable for nearly a decade, hardly breaching Ksh. 80 to the US dollar since 2003. However, the shilling depreciated sharply in 2011 to levels seen in the height of the Goldenberg scandal in the 1990's. By mid-October 2011, the Kenyan shilling had depreciated sharply against major currencies, hitting a historic low of Ksh.107 against the US dollar.
- 1.2 The combined effects of rising inflation and a weakening shilling presented a toxic risk to Kenya's economy not seen since the 2008 electoral disturbances. Indeed, these problems drastically increased the cost of living and made life unbearable for majority of Kenyans, including posing a real risk of economic slump and a rise in poverty levels as well as the number of Kenyans that were predisposed to eminent poverty due to decline in purchasing power. This was a cause of concern among citizens and their elected representatives.
- 1.3 As a result, the House formed the Select Committee to investigate the rapid decline of the Kenya shilling. Drawing from the Motion, there was concern that the Central Bank of Kenya had maintained a "*watch and see attitude*" and had publicly admitted that it could not control the currency slip citing that some commercial Banks were holding foreign currencies and that the problem may persist for another six months.
- 1.3 The Members were also concerned that effort by a Task Force established by the Rt. Hon. Prime Minister to help stabilize the shilling, the interventions by the Monetary Policy Committee, and the interventions by Treasury had not borne fruit.
- 1.4 The pressure for the Central Bank of Kenya to intervene persisted throughout the year, but it was only in October 2011 that CBK

increased the Central Bank Rate (CBR) to 11 percent. On November 1, 2011 the CBK further raised the CBR rate to 16.5 percent and again to 18 percent in December. This has contributed to high lending rates, some as high as 32% that are threatening to turn middle class majority of Kenyans into paupers.

- 1.5 The Committee in its sittings particularly explored the causes of the drastic fall of the Kenya shilling throughout 2011 but with specific reference to the most turbulent period: September to October 2011. The Committee also sought to identify any policy failure or inaction among key institutions such as the CBK, or any fraudulent and speculative activities of Commercial Banks or other institutions.
- 1.7 The Committee held sittings to investigate the reasons for the fall of the Kenya shilling with various institutions and stakeholders among them, the CBK, Ministry of Finance, Task force at Office of the Prime Minister, Capital Markets Authority, Kenya Bankers Association, eight Commercial Banks, Academic and Research Institutions, former Governor of Central Bank and several economic experts.
- 1.8 These factors are explored below including synthesis of findings and presentations from various witnesses who appeared before the Committee. Specific recommendations are also put forth to address the policy failures and other factors and to ensure that this economic disaster does not recur again.

## CHAPTER TWO

### SUBMISSIONS TO THE SELECT COMMITTEE

#### 2.0 GOVERNMENT INSTITUTIONS AND AGENCIES

##### 2.1 Central Bank of Kenya (CBK)

###### Submissions

2.1.1 The CBK Governor presented to the Committee the key causes for the fall of the shilling. Among these factors include the following: rising inflationary pressures, rising fuel prices in over 10 months period at a price above US\$ 100, very high fuel import bill that rose from 19.2 percent in January 2011 to 31 percent in August 2011, huge current account deficit of about 12 percent to the GDP, Euro zone and US debt problems that contributed to instability in international foreign currencies. The fall of the shilling was also attributed to prolonged drought resulting in food shortages and hence high food import bill (during this time, sugar became an extremely important/expensive import commodity), and high private sector credit.

2.1.2 The Central Bank singled out the current account deficit as one of the primary factors driving the fall of the shilling. For example, for the month of September 2011 alone, the difference between imports and exports stood at US\$ 576.7 million, while in November 2011, this difference amounted to US\$ 693 million. Indeed, exports have been financing only 51 % of imports which means that the country was losing foreign exchange at an alarming rate. This is a fundamental problem with the economy which requires strong export policies (see other submissions and recommendations). The CBK also blamed the fall of the shilling on the strengthening of the US dollar internationally following the Euro zone debt crisis.

2.1.3 Further, the Governor in his presentation argued that since Kenya is a small open economy (with open capital account and floating or

flexible exchange rate) any major international shocks could have a direct effect on the exchange rate and domestic prices. Apart from the problem with high import bill relative to exports (large current account deficit), the exchange rate is also affected by changes in prices in Kenya's trading partners, the size of Kenya's official foreign exchange reserves, and the country risk profile. According to the CBK, countries such as South Africa, Tanzania and Uganda also experienced steep depreciation of their currencies in the period April to September 2011. Most countries around the world intervened to address the fall of their currencies, but the effectiveness of this was constrained by the level of foreign exchange reserves available.

2.1.4 With regard to the pertinent issues requested from the CBK, such as whether the Bank had made any ad hoc visits to commercial Banks during the time of exchange rate crisis, or whether the Bank had sent any warning letters to Banks regarding their foreign exchange trading activities, or whether the CBK had taken any supervisory interventions such as suspension from the interbank market or any other measures, the CBK clarified the following:

- (i) **The use of the Discount Window:** The CBK had issued circular to curtail the capacity of Banks to borrow from the Discount Window for speculation. The CBK issued circulars specifying the frequency and amounts that could be borrowed from the Window. The Banking Circular No. 5 of June 29, 2011 set the Discount Window rate at 8% (above the CBR rate) and announced stiff penalties for Banks using the Window to trade in the interbank market. Further, operations in the interbank and foreign exchange dealings were checked before commercial Banks could access this borrowing. (see annex 2).
- (ii) **Regulatory actions and visits to financial institutions:** the CBK made regular audits of all Banks involved in foreign exchange dealings particularly relating to their use of the Electronic Brokerage System

which the CBK believed could cause arbitrage opportunities. The visits found that commercial Banks had substantial amounts of foreign exchange assets and that the demand for foreign currencies by importers of food and oil were causing speculation on the price of foreign currencies.

- (iii) **Warning Letters related to trade in foreign exchange, use of the Discount Window and Participation in the Interbank Market:** the CBK clarified that there were no warning letters issued, but there were letters sent to various Banks requesting clarification and explanations on various issues in accordance with Section 33F of the Central Bank of Kenya Act. In addition all circulars and any changes to guidelines relating to foreign exchange trading, the use of the Discount Window and participation in the interbank market were duly communicated to all commercial Banks. Letters requesting explanations were issued to three Banks that handle large foreign exchange reserves and that had increased foreign exchange activity. Information provided by the Governor shows that the three top Banks by September 2011 controlled 42.2% of total foreign assets in the Banking system (approximately Ksh. 174.5 billion). The Governor reported that adequate explanations were provided by the Banks during the visits.
- (iv) **Banks that had high foreign exchange trading activity:** The Governor provided the names of the Banks that had increased foreign exchange activity. But, as noted in above bullet, these Banks provided adequate explanations during the visits (see annex 3).
- (v) **Suspension of specific financial institutions from participating in the interbank market or foreign exchange market:** The Governor reported that one Bank had flouted the Guidelines issued on October 13, 2011 regarding the tenor of foreign currency swaps. The Bank was suspended from participating in the swap market for 30 days and was also penalized Ksh. 1 million in line with the

Banking Act (Section 2(a) of Legislation No. 77 of 1999: The Banking (Penalties) (Amendment) Regulations 1999).

- (vi) **Other Regulatory Interventions by the CBK:** to deal with the problem of the exchange rate the MPC held a special meeting and thereafter held monthly meetings to deal with the currency crisis. The CBK also suspended the use of Electronic Brokerage System by Banks, limited the tenor of foreign currency swaps where offshore Banks were involved to not less than one year, and limited the tenor of swaps between residents to a period not less than seven days. Apart from reducing the foreign exchange exposure ratio from 20 to 10% (through a letter to Chief Executive Officers of commercial Banks on 13<sup>th</sup> October 2011), the CBK also required Banks to obtain supporting documents for all transactions in the Nostro accounts of offshore Banks.

2.1.5 To respond to the developing problem of the exchange rate, the CBK made various policy measures in form of circular issuance to the Banks, changes in the guidelines and changes to prudential regulations. The CBK uses various instruments to control the behavior of and capacity of commercial Banks to adjust their portfolios (for example to curtail harmful adjustments of portfolio). Normally, the usual deals in foreign exchange are done on behalf clients, and others are done on the basis of a Banks analysis or expectations of the movements in the exchange rate given the knowledge of when they expect the clients will require or provide the foreign exchange. For example the Banks could temporarily hold foreign exchange if they expect it to depreciate further, or to avoid losses. Commercial Banks adjust their foreign exchange portfolios relative to their holdings of assets denominated in Kenya shilling depending on market conditions and liquidity conditions. This is standard market behavior in competitive foreign exchange market and is followed up in the recommendations (supervisory operations, etc).

2.1.6 To curtail volatility in the foreign exchange markets the CBK uses or used instruments that include, the cash reserve requirements, foreign exchange exposure limits, guidelines on tenor limiting hedging, access to foreign exchange facilities, and liquidity management through the open market operations. The CBK Governor also provided information about policy responses that the Bank had taken to address the fall of the shilling (and also to reduce inflationary pressures). These responses include:

- (i) Tightened monetary policy; on 5<sup>th</sup> October 2011, the CBK raised CBR to 11%. On 1<sup>st</sup> November 2011, the CBR was further raised 16.5% and the cash reserve ratio was also increased to 5.25% from 4.75% effective from 15<sup>th</sup> December 2011. In December 2011, the CBK further increased the CBR rate to 18 % (see annex 2).
- (ii) The CBK also introduced guidelines on foreign exchange exposure and trading. For example, the CBK reduced commercial Banks foreign exchange exposure from 20% to 10% to control trading in foreign exchange.
- (iii) The CBK also made sales of foreign exchange. But, sales of foreign exchange reserves by the CBK were complemented by other measures in stabilizing the exchange rate. The sales were limited by the amount of foreign exchange reserves available to the CBK.

2.1.7 It can be noted that on this, changes to the cash reserve requirements to 5.75%, the rise in the CBR rate to peak at 18%, and changes in the foreign exchange exposure limits have forced Banks to adjust their portfolios. These adjustments may include dumping of foreign exchange denominated assets (thus occasioning the strengthening of the shilling), shift from treasury bonds and bills to interbank lending or to foreign exchange credit lines among others. For example, some Banks hold significant cash surpluses to profit from the interbank market.

2.1.8 With regard to the Discount Window of the CBK, the Governor said that commercial Banks come to the CBK as a lender of last resort especially when the interbank market rates are high. High interbank interest rates often indicate tight liquidity especially following the increase in the CBR rate to 18 percent and the cash ratio from 4.75% in May 2011 to 5.25% in November 2011. The increase in the CBR rate increased the lending rates of interest in the country. In response to the negative effect of the increase of the CBR rate the Central Bank has met with the Kenya Bankers Association on the interest rates charged to existing loans and agreed on restructuring the loans in consultation with the borrowers.

2.1.9 The CBK Governor also reported that the Government had committed to review its budgeted expenditures to cut down on non-priority area. This was expected to support the tight monetary policy pursued by CBK. The Governor reiterated that the priority was to bring inflation and inflationary expectations under control and also to protect the economic growth base. The CBK would also seek to build up foreign exchange reserves as buffer, but its interventions in the foreign exchange market will only be done to dampen volatility of the exchange rate. The Governor also said that interactions with market players will be sustained to enhance the effectiveness of the transmission mechanism of monetary policy and policy actions.

2.1.10 The Governor however refuted claims that the CBK favours certain Banks in the country arguing that the Discount Window was open to all Banks. He also refuted the allegation that he did not do much to arrest the fall of the shilling. He explained that the CBK needed to assess the market before taking any action since some of the market activities or financial products were new. The Governor also defended his competence in running the CBK.

## Observations

2.1.11 Tracking CBKs response to the exchange rate and inflationary pressures throughout the year could provide a hint on what may have gone wrong. The CBK firstly increased the CBR on March 23, 2011 from 5.75% to 6% and was revised again to 6.25% on 4<sup>th</sup> June, 2011. The CBR rate was not reviewed again until September 15<sup>th</sup>, but this was raised to only 7%. Thus, though the Kenya shilling was rapidly losing value and inflation was rising, the CBK still kept the CBR fairly flat for about 9 months.

2.1.12 During this time, the CBK was implementing other measures including interventions on the Discount Window and interbank market. The significant raise in the CBR rate came through the Circular of October 6, 2011: raising the CBR from 7% to 11%. Further adjustments came in November 2, 2011 when the CBR was raised to 16.5% (cash reserve ratio was also increased to 5.25% from 4.75% to be effective in December 2011), and again in December 2, 2011 when the CBR rate was increased to 18%.

2.1.13 Regarding the use of the Discount Window, the CBK corrected the mismatch between the CBR and Window rate on 29 June, 2011 when the Window rate was raised to 8%. However, through the Banking Circular No. 6 of 11<sup>th</sup> July, 2011 the CBK reviewed the Discount Window downwards from 8% to 6.25%, though there were additional restrictions on the use of Window such as barring Banks that were lending in the interbank market from accessing the Window the same day. This could have effectively sealed the loophole where Banks were borrowing at a low rate through the Window and lending at a higher rate in the interbank market. Successive review of the Window rate and guidelines for accessing it indicate continued adverse use of the window by Banks (arbitrage).

2.1.14 The Committee can infer that in fact Banks were using the Discount Window to lend in the interbank market the same day or the next day

since the Banking Circular No. 8 of August 12, 2011 sought to curtail this practice. Also, the revised formula of the Window rate which would ensure the rate was higher than the interbank rate plus a penalty sought to dissuade Banks from using the difference in the Window and interbank lending rate for profit. Also, eligibility to access the Discount Window funds was also determined by the Banks trading behavior in the foreign exchange markets. Further, measures to strengthen and to close the opportunity for arbitrage created by the mismatch among major short term interest rates were issued in successive circulars.

2.1.15 What we note from these two observations is that the mismatch between the Discount Window and the interbank lending rate, and the low rates available through the Discount Window created opportunities for arbitrage by Banks, which when the funds were used in the trading in foreign exchange created further volatility in the exchange rate. This particularly took place from about May 2011 to about September 2011. This was significant since these activities worsened the direction of exchange rate expectations: further worsening the slide of the Kenya shilling. The Committee notes that lack of quick action to close these opportunities could have caused this. The problem of the exchange rate could have been addressed to a great extent through a rise in the CBR as early as June 2011 and also the placement of stringent penalties for the abuse of the Discount Window.

2.1.16 The mitigating factor is that the movements in the exchange rate could have been in other ways fueled by the rising inflation and external factors (such as movements of short term capital due to the Euro crisis). The CBK Governor however noted that the CBK needed to act on the basis of analysis of unfolding developments, so the Bank did not act as fast as the situation may have required.

2.1.17 The Committee notes that the CBK ACT (CAP 491), Section 10 provides that the Board of Directors whose Chairman is the Governor of CBK should (a) “keeping under constant review the performance of the Governor in discharging the responsibility of that office; (e) keeping under constant review the performance of the Governor in ensuring that the Bank achieves its objectives. The Committee observes that the Board of Directors, for which the Chairman is the Governor, cannot effectively review the performance of the Governor. Also, the Committee noted the two roles of the CBK: price stability and the regulation of the financial sector. Are these roles complementary under the same institution or do best international practices indicate the need to separate these two roles?

### Recommendations

2.1.18 The Committee concurs with some of the reasons for the fall of the shilling last year given by the CBK (and also other witnesses) such as Euro- zone crisis, US debt crisis, North Africa political turmoil, and world oil prices among others. That the reasons advanced remained fairly the same even after November 2011, when the shilling started to strengthen is a strong pointer that internal dynamics played a role in the decline of the shilling and that had certain aspects of the Banks behavior been addressed, the depreciation of the shilling would have been less violent. The Committee therefore isolated three factors as the primary drivers of the sudden fall of the shilling particularly between May 2011 and October 2011:

- (i) The abuse of the Discount Window and related trades in foreign exchange;
- (ii) Overuse of various foreign exchange trade tools such as Electronic Brokerage System, currency swaps, and carry trades (most of them within legal limits); and,
- (iii) The delay in CBK to detect the problem and respond adequately in a timely manner.

2.1.19 Regarding the overuse of various financial innovations to make profits at the expense of the exchange rate, it is noted that this is in financially developed markets quite part of standard market behavior. Given that Kenya's financial sector is quite sophisticated, and given that Kenya holds an open capital account and floating exchange rate, and given the inter-linkages of the Global financial markets. It would be hard to roll back progress in financial innovations in foreign exchange or scale down the level of liberalization. It is therefore the Committee's primary assessment that the CBK needs to develop tools or abilities to properly and efficiently monitor the financial markets, particularly find tools to quickly deal with the adverse effects of innovations in foreign exchange trades such as the Electronic Brokerage System, swaps and carry trades.

2.1.20 The CBK should therefore urgently develop or strengthen capacity to monitor the financial markets so as to redress any sharp deviations from the normal market trading. The CBK needs to increase the speed and responsiveness to market developments and also to strengthen response to control rapidly changing market behavior in a way without curbing the normal operations of the markets. In addition, the CBK should put in place a reasonable threshold or trigger point at which the CBK could take action if the shilling depreciates or appreciates by a certain margin. The Committee also suggests the need to share this information with an active oversight institution during times of crisis. Penalties for non-adherence to prudential and other supervisory regulations and guidelines should be enhanced including custodial sentences and or stiffer monetary penalties among others.

2.1.21 As noted in the Committee observations, the abuse of the Discount Window could have been prevented if action was taken in a timely manner. In order to uncover any wrong doing relating to the use of the Discount Window during the period March 2011 to October 2011, the Committee further recommends a forensic audit of Banks books during the period when there was massive abuse of the Discount

Window. This should be instituted if the Banks breached any regulations at the time and if the required penalties were not applied.

2.1.22 Though not directly apparent, some of the problems associated with the fall of the shilling and the lethargic response by the CBK could be related to the operations of the CBK. The Committee therefore recommends a review of the structure and operations of the CBK with a view to making the institution more efficient and responsive to monetary crisis.

2.1.23 In addition, the CBK Act should be amended to provide that the CBK Governor cannot chair the Board of Directors of CBK which is expected to review the office holder's performance in achieving the objectives of this critical institution. The Committee also recommends a review of the structure of the CBK so as to strengthen the roles of maintaining price stability and the role of regulating the financial sector. Noting that the financial markets are quite critical in the transmission of monetary policy and performance of exchange rate, the Committee recommends having adequate representation from the Bank supervisory arm of the CBK in the Monetary Policy Committee. The Committee therefore proposes amendment of CBK Act to provide for an extra member to the MPC of a CBK staff responsible for Bank supervision.

## 2.2 Ministry of Finance

### Submissions

2.2.1 The Ministry of Finance attributed the decline in the value of the shilling to external factors such as rise of crude oil prices, higher import bill due to increased spending in infrastructure such as energy and also due to internal factors. In response to the exchange rate crisis the Ministry took the following steps:

- (i) Sent circulars to all Government departments to reduce unnecessary expenditure such as those on foreign travel and furniture. Savings amounting to about Ksh. 5 billion were made due to these measures alone.
- (ii) Reducing the budget deficit by 1 percent in the macroeconomic framework.
- (iii) Sought and received an extension of the Extended Credit Facility (ECF) from IMF. The country has accessed amounts exceeding USD 300 million since early 2011, under the three year ECF program (see annex 4).

2.2.2 In addition, Treasury participated in meetings with the CBK, commercial Banks, the Kenya Bankers Association, and a Task force in the Office of the Prime Minister on the issue of the exchange rate and to help manage expectations.

### Observations

2.2.3 The Committee noted that the Ministry of Finance seemed unaware that it could legally intervene and take over monetary policy through the cabinet if it felt that CBK had failed or had pursued unsuitable policies or had deviated substantially from the Monetary Policy Statement. This was through the Central Bank of Kenya Act Cap 491 4(c)2).

2.2.4 The crisis of the shilling and the time lapse in instituting interventions points at some disconnect between the monetary and fiscal policy actions. The Committee notes that the monetary policy actions were not immediately backed by corresponding fiscal actions to stem the shilling decline. Fiscal spending restrictions were not forthcoming at the height of the crisis.

## Conclusion and Recommendations

2.2.5 The Committee is of the view that the Ministry of Finance could have played more active role to help stabilize the Kenya shilling. Also, it is apparent that little has been done to address the chronic low export earnings relative to the import bill. More importantly, was the observation that the Ministry of Finance has the powers in the Central Bank Act to take over monetary policy making through the cabinet if the CBK shows inability or unwillingness to pursue the intended monetary policies under the Monetary Policy Statement. To help address the shortcomings in the fiscal side the Ministry of Finance should make policies to reduce the current account deficit. Secondly, the Ministry of Finance should familiarize itself with the CBK act and draw possible grounds for interventions in monetary policy decision making and execution.

## 2.3 Kenya Revenue Authority

### Submissions

2.3.1 The Committee met with the Kenya Revenue Authority, on 8<sup>th</sup> December 2011. The Committee was informed as follows:

- (i) During the period July to November 2011, KRA collected Kshs 266.7 billion (of which Kshs 252.2 billion was exchequer revenue) compared to Kshs 237 billion in a similar period of FY 2010/2011.
- (ii) Petroleum taxes recorded a growth rate of 1.2 % in the period July – November 2011, compared to a similar period in 2010/11.
- (iii) During the period July to November 2011 indirect taxes registered a decline of 3.4% compared to a similar period in 2010/11. Principal under performers were VAT, Domestic Excise and Excise on air time.
- (iv) Since September 2009, the shilling had been depreciating against the major currencies and particularly the dollar. This affected the FOB value eventually influencing volumes purchased for importation to Kenya.

- (v) The imports and exports volumes over 2011 to the end of November grew by 11.1% and 14.6% respectively.
- (vi) The taxpayers who heavily depend on imported raw materials or products and services were caused to increase the cost of production. This mostly resulted in reduced sales revenues and VAT collections.
- (vii) Banks may have realized foreign exchange gains which impacted positively on their profitability.
- (viii) The Central Bank measure to minimize exchange rate volatility through increased Bank rate caused Banks to increase their lending rate which may have resulted in bad debts due to defaults, reduced borrowing, which in the long run would impact their profitability.
- (ix) The weakening shilling piled pressure on sales of used cars whose orders dropped by 18.2% in the third quarter, thus raising the cost of used cars.

## Observations

2.3.1 From the interaction with the Kenya Revenue Authority, the Committee observed the following:

- (i) The poor performance in petroleum taxes was attributed to the rising prices of oil in the world oil markets which undermined import volumes and depreciation of the shilling against other major currencies.
- (ii) The decline in VAT was largely attributed to the rolling back of withholding VAT which allowed for the VAT to be withheld and remitted directly. VAT was also impacted on by the exchange rate which by raising import values increased the deductions on import VAT. Excise duty on domestic products was affected by a drop in production quantities which could not be attributed to the exchange rate movements. Excise duty on airtime poor performance was a result of the price war in the telecommunications.

- (iii) The value of growth in the imports and exports volumes over 2011 was primarily driven by the depreciation of the currency and unit price of imports. But, the weakening shilling denied the economy the benefits of the ongoing fall in global crude prices, despite the fall in the international oil markets.
- (iv) The depreciating shilling resulted in higher revenue outrun as importers paid more shillings for foreign currencies. There was however a decline in volume of imports as was shown by Import Declaration Fees and in addition, the high inflationary environment and the exchange rate gains were eroded by inflationary pressure.
- (v) Companies who heavily depend on imported raw materials increased the cost of production thus impacting negatively on domestic taxes.
- (vi) Those tax payers with loans denominated in foreign currency incurred foreign exchange losses which affected profitability. When businessmen suffer exchange rate losses these are deductible expenses which undermine corporation taxes.
- (vii) The key requirement for revenue performance is stability of key economic parameters so that business does not adopt a wait and see attitude with respect to investment and expenditure.

## **2.4 Taskforce on the Decline of the Kenya Shilling (Office of the Prime Minister)**

### **Submission**

2.4.1 The taskforce had been set up by the Prime Minister to investigate the causes of the decline after it was evident that measures being undertaken by the CBK and the Treasury were not bearing fruit. It was comprised of Dr. Edward Sambili, Mr. M. Isihakia, Dr. Chris Kiptoo, Mr. Mugo Kibati, Mr. Gerald Nyaoma, Mr. Habil Olaka, Mr. Anthony Weru and Mr. A.K.M. Kilele.

2.4.1 The Committee met with the Taskforce on the Decline of the Kenya Shilling, on 25<sup>th</sup> January 2012. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) Deterioration of current account: the rise in the current account has been gradual and sustained reaching a peak of about 11.9 % of GDP by July, 2011, thus exerting considerable pressure on the exchange rate. The widening of the current account emanates from a growing gap between exports and imports of merchandise goods. This mainly reflects the impact of higher prices for oil and chemicals imports.
- (ii) Domestic demand driven by private sector credit expansion as well as increase in public investment in 2010/11 also increased pressure on the current account. Also, credit that grew at about 32% had grown faster than average for real estate, consumer durables and domestic trade components that are highly correlated with domestic demand. These developments have been reflected in the deterioration in the current account deficit.
- (iii) Unrest in Arab States led to rise in oil prices and the import bill. High oil prices domestically also drove inflation in 2011.
- (iv) The Euro zone debt crisis especially in Greece, Portugal and Spain also made investors (local and foreign) sell their securities (shares, bonds) to buy foreign currencies as a relatively safe haven.
- (v) The depreciation of shilling was also driven by the sentiments of the financial markets rate - speculators may have read the market and taken the position that the shilling will weaken further thus raising demand for more foreign currency in order to make a profit.
- (vi) Also, the response by the CBK was not clear and was inconsistent. The CBK's inefficiency in dealing with the problem at its onset could have been a major cause of the continued depreciation. There was no dialogue between the CBK and the commercial Banks yet the CBK is their regulator (see annex 5).

## Observations

2.4.2 From the interaction with the Taskforce on the Decline of the Kenya Shilling, the Committee had the following observations:

- (i) There should be more effective dialogue between the CBK and the private sector, more specifically the CBK and corporate player's in the foreign exchange market and Government. The Committee observed that credibility is of critical importance on the part of the regulator and that this credibility could be enhanced through engaging in more effective dialogue.
- (ii) The Government should make efforts to increase spending capacity of its ministries so as to increase absorption of donor funds that in turn will help build foreign exchange reserves.
- (iii) The CBK's announcement that it will sell foreign currencies directly to importers and bypassing Banks is a violation and disregard to financial structures.

## Recommendation

2.4.3 The announcement and release of CBK circular to bypass the Banking system and deal directly with buyers or sellers of foreign exchange, although reversed, was in complete disregard of the financial structures. This could have opened opportunities for rationing of foreign exchange, occasioned parallel markets to thrive and creation of multiple currency practices. In addition, the capacity of the Governor was found wanting (see annex 6).

## 2.5 Energy Regulatory Commission (ERC)

### Submission

2.5.1 The Committee met with the Energy Regulatory Commission, on 6<sup>th</sup> December 2011. The following are the key submissions from the Commission:

- (i) The present high cost of fuel was being experienced globally since the international prices of crude oil had gone up. The increase was partly due to the political crisis in the Arab oil producing states like Libya. Since the imported petroleum products are paid for in US dollars, when the prices of fuel increased internationally,

Kenya had an increase in the import bill. This led to an increase demand for foreign currencies and could have escalated the decline of the Kenya shilling.

- (ii) That there has been an increase in pump prices of 32.0% for super petrol, 30.7% for diesel and 25.1% for kerosene and these changes reflects the increases in the cost of products.

## Observation

2.5.2 From the interaction with the ERC, the Committee observed that indeed external factors attributed to have caused the decline of the shilling still persisted and did not therefore contribute significantly to the decline of the shilling. The Committee however observes that the ERC pricing mechanism is a major concern within the economy since contributing to the high cost of oil 75% of the crude oil cost at source.

## 2.6 Capital Markets Authority (CMA)

### Submission

2.6.1 The Committee met with the Capital Markets Authority, on 28<sup>th</sup> November 2011. The Committee was informed as follows:

- (i) There was a decline in the stock market index depicting a decline in the capital gains of the companies listed in the stock market in Kenya. Quite a number of these companies heavily rely on imported goods and when the exchange rate increased, there was an increase in the cost of production. This reduced their potential profits.
- (ii) Capital flight from the stock market caused by political uncertainties and ICC cases, and in the second round the rapid fall of the shilling could have been caused by subsequent investors dumping the shilling for the foreign currencies.
- (iii) Though there was a high capital outflow, some of the money seems to be coming back since the total inflows from October 2010 to October 2011 net amount of Ksh5.1 billion.

- (iv) In responding to questions by the Committee about insider dealings and foreign exchange hoarding, CMA affirmed that there were no cases of insider dealing that the Authority was investigating or aware of in relation to the depreciation of the Kenya Shilling. Further, there was no evidence that foreign exchange fluctuations were as a result of investments at the capital markets. There was no consistent indication of a link between the depreciation of the shilling and net foreign equity flows. At the point when the net outflow was highest (3.3bn), the Kenya shilling was at 85.70 to the USD. As the Shilling continued to depreciate, foreign equity flows did not move commensurately in the same direction.
- (v) The market information did not show that the weak shilling increased foreign investor flows into the country. The correlation between the depreciation of the shilling and net foreign equity flows was weak, unpredictable and inconsistent. The equity market experienced net foreign equity portfolio outflows when the shilling was relatively stable. At the shilling weakest points, between August and November 2011 the equity market experienced positive (but not highest) foreign equity portfolio flows.
- (vi) The weaker shilling had more significant impact on foreign investors (who are mostly institutions) whose asset valuation declined as a result of exchange rate losses and not local individual (retail) investors (see annex 7).
- (vii) The depreciation of the shilling affected yields on already held bonds (by Diaspora or foreign investors who had to convert periodic returns from bond investment into their host country's currency) leading to lower returns and discouraging investment in fixed income securities.

## Observations

2.6.2 From the interaction with the CMA, the Committee observed the depreciation of the Kenya shilling affected the cost structure of listed companies which rely on imports. Higher import costs affected their projected earnings which further triggered the fall in the price of the

listed shares. In addition, the decline of the shilling caused companies to postpone conducting Initial Public Offers (IPO) fearing under-subscription. Thus, the shilling decline was partly to blame for the drop in the NSE 20-share index. Also, ordinary retail investors may have sold their shares to cope with the high cost of living associated with the weak shilling and inflationary pressures.

2.6.3 Even though the capital markets are central in the financial sector and are highly exposed to fluctuations of the shilling and global financial events, the Committee found minimal interactions between this market segment with the CBK and Treasury regarding prevailing economic conditions and monetary policy. The huge erosion of investor wealth which could be associated with the shilling volatility should be of great interest to policy makers in the three institutions.

2.6.4 The CMA was not forthcoming with specific information requested by the Committee and did not appreciate the role of parliament and section 125 of the constitution.

## Recommendations

2.6.4 Owing to the importance of the capital markets in Kenya's development process, and as a source of affordable non-Bank capital for listed companies, the Committee recommends the need for the Ministry of Finance, CMA and CBK to consult regularly regarding unfolding economic conditions and ways to redress them so as to secure investor wealth.

2.6.5 Amend Capital Market Authority Act to provide that the CMA chief executive briefs a relevant Parliamentary Committee of National Assembly on a quarterly basis.

2.6.6 The CMA to conduct a comprehensive investigation of the NSE to determine the institutions involved in huge capital inflows and outflows from the equity market.

## 2.7 Kenya Tourism Board

### Submission

2.7.1 The Committee met with the Kenya Tourism Board, on 6<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) Widening current account deficit due to a high oil import bill and increased importation of infrastructure for development.
- (ii) The shilling's depreciation also could have been caused by the global economic volatility attributed to the Euro zone sovereign debt crisis and currency speculation activities within the foreign exchange market.

### Observations

2.7.2 From the interaction with the Kenya Tourism Board, the Committee observed the following:

- (i) Though the rapid decline in the shilling hurt the aggregate economy, the depreciation was beneficial to both foreign tourists and the tourism sector since foreign tourist products are priced in foreign currency and this means that local destinations and Kenyan products were viewed as affordable in terms of direct expenditure. There was increased revenue once the hoteliers, tour operators and airlines converted the currencies into shillings.
- (ii) There were negative effects also in the sector since domestic tourism had reduced revenue margins. The high domestic rates reduced the appeal for domestic tourism in leisure, business and conferencing as individuals and organizations shifted adjusted their spending priorities to cope with the high inflation rates.
- (iii) The CBK's monetary policy actions measures in the foreign exchange market helped restore confidence in the market and stabilized the shilling.

## 2.8 Kenya Ports Authority (KPA)

### Submissions

2.8.1 The Committee met with the Kenya Ports Authority, on 8<sup>th</sup> December 2011. The Committee was informed as follows:

- (i) The amount of imports coming through the port of Mombasa has been on the rise. Port traffic was heavily skewed in favour of imports, a trend that had been growing from year 2001. This share was 84% imports and 14.5% exports in 2011.
- (ii) There was a slight decline in the in imports as the shilling became weaker. This was because the imports became expensive as the shilling weakened and the cost of importation increased since they are paid in foreign currency. This could have increased the demand for foreign currencies in the market.
- (iii) The country has been importing a lot of grains as depicted by a steady rise in volume of grain imports over the years. This shows that the country has been depending a lot on imported food.
- (iv) To cushion Kenyans against the effects of the decline of the shilling, Kenya Ports Authority provided 24/7 port operations to ensure that cargo do not incur charges, maintained the same charges as per the tariff effective 1<sup>st</sup> of February 2008 with minor amendments, removed scanning verification charges, contracted eight CFSs that helped to decongest the Port and facilitate cargo movement.
- (v) The Authority hoped to upgrade the port to an E-port by 2012 and also submitted proposals for development of additional port capacity. The Authority's recurrent expenditures such as fuel for equipment and maintenance of spare parts that are purchased overseas were also affected.

### Observations

2.8.2 From the interaction with the Kenya Ports Authority, the Committee observed the following:

- (i) There is a relationship between currency fluctuation and the volumes of imports. Notably, the weakening of the shilling led to a marginal drop in imports, but overall the demand for imports has remained high. This implies it is not possible to reduce the import bill through currency depreciation; rather the Government needs to put in place tariff and non-tariff barriers to deal with the problem of huge imports.

## 2.9 Kenya Institute for Public Policy Research and Analysis (KIPPRA)

### Submission

2.9.1 The Committee met with KIPPRA on 1<sup>st</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) Large current account deficit due to fast growth in import payments relative to slow growth in export receipts. This put pressure on the shilling to depreciate.
- (ii) Government introduced a fiscal stimulus package in 2009 causing Government expenditure to rise rapidly. The budget deficit also increased showing that the Government was relying more on CBK's advances and by September 2011, the CBK's overdraft facility stood at 25.4 Billion. Increased spending by the Government may have played a big part in the depreciation of the shilling.
- (iii) Monetary expansionary since 2008 is related to fast growth in private sector credit which caused inflationary pressures in the economy. This indirectly contributed to the fall of the shilling.
- (iv) The Europe debt crisis forced jittery investors to shift from Euro to dollar denominated assets. This caused the dollar to appreciate against other currencies including the Kenya shilling.
- (v) CBKs announcement that it would sell foreign currencies directly to importers caused panic in the market.

- (vi) When the shilling started falling, individuals and Banks could have taken speculative positions so as to benefit from the declining shilling through hoarding of foreign currencies. This could have escalated the decline of the shilling.

## Observation

2.9.1 From the interaction with KIPPRA, the Committee observed the need to closely monitor fiscal policy so as to reduce expenditure on non-essential and non-priority items in the short-term. Loose monetary policy was a major catalyst of the fall of the shilling and so it should be tightened to reign on inflation and excess money in the economy. In addition, the problem of the wide current account deficit was structural; hence the need to change Kenya's production structure towards increased export production.

## 2.10 Export Promotion Council (EPC)

### Submission

2.10.1 The Committee met with EPC on 6<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) Limited export product range and reduced foreign exchange inflows. This has reduced the national capacity to cover the import bill from the exports proceeds and also constrained the capacity of the treasury and CBK to employ effective monetary and fiscal policies that will ensure a stable exchange rate.
- (ii) Uncertainty over the Arab spring in the Middle East and North Africa states caused a rise in oil prices, which resulted in a larger import bill.
- (iii) Kenya had been in a heated political environment for the better part of 2011 with the upcoming elections and the ICC trials debate. This has made investors who anticipate election violence to take off causing capital flight.

- (iv) Speculation by importers so as to get favorable forward purchases in the wake of a depreciating shilling.
- (v) The oscillating shilling created an uncertain environment for production and other structural issues. It was conducive for planning for production. This has negatively impacted on long term investments and also induced capital flight.

2.10.2 The EPC also informed the Committee that the weak shilling had a positive impact on exports earnings. But this advantage has not been fully felt in the market since the Kenya exports raw products with limited valued addition. Kenya lacks high value capital products.

### Observation

2.10.3 From the interaction with EPC, the Committee noted that the Government had not created adequate domestic business environment that can lead to rapid export growth. This is causing capital flight and disinvestment by foreign investors. Since increased fuel prices contribute to the fall of the shilling, the Government should invest in alternative energy resources.

## 2.11 Kenya Investment Authority (KenInvest)

### Submission

2.11.1 The Committee met with KenInvest on 14th December 2011. The Committee was informed as follows:

- (i) There have been unsteady Foreign Direct Investment (FDI) inflows to the country over the recent years. Though this is a major source of financial and technological resource to the country, no agency has been mandated to record the FDI inflows in Kenya making their role undocumented.
- (ii) The ease of doing business in Kenya has deteriorated with Kenya being ranked 109 for the year 2012. This affects FDI directly since investors want to be assured of security, conducive business

environment and most importantly minimal bureaucracy and corruption.

- (iii) The cost of doing business in Kenya is also worrying since some of the essential services like energy are very expensive and unreliable. The Government should provide the necessary infrastructure and services so as to encourage foreign investors to come invest in the country.
- (iv) Many foreign investors are unable to startup businesses in Kenya due inability to access land. The Government should create land Banks in each and every county specifically for investors.

## 2.12 School of Economics, University of Nairobi

### Submissions

2.12.1 The Committee met with the School of Economics, on 1<sup>st</sup> December 2011. The Committee was informed that the causes of the decline of the shilling were as follows:

- (i) Lack of clear monetary policies. CBK Governor intervened from the demand side ignoring the supply side.
- (ii) The Central Bank of Kenya should have predicted possible failure and act fast but there was some laxity on the part of CBK.
- (iii) Market distortions. The level of exchange rate is determined by the forces of demand and supply of foreign currency. Under normal circumstances, there should not be a sharp rise in the exchange rate. Something else, therefore, may have caused the sharp decline of the shilling.
- (iv) The international forces like Euro crisis and the Arab spring may have been a driver at the onset but could not warrant the sharp decline of the shilling.
- (v) Pressures from the increased import bill could have contributed to the fall of the shilling. There had been an increase in importation of commodities that should not ordinarily be imported like foodstuff.

2.12.2 The School of economics further furnished the Committee with the following information:

- (i) The intervention measures taken by CBK will have serious impact on the growth of the economy as people will not have money to invest although the inflation will be tamed in the short run.
- (ii) Long term borrowing for development is likely to lead to undue expectation by the public. The Government will have to make substantial borrowing to meet those expectations.

### Observations

2.12.3 The Committee observed that the primary causes of the depreciation of the Kenya shilling exchange rate were economic and also market distortions due to ineffective intervention and monitoring in the foreign exchange markets.

## 3.0 COMMERCIAL BANKS

### 3.1 Equity Bank Limited

#### Submissions

3.1.1 On the causes of the decline of the shilling, Equity Managing Director blamed it on: large oil import bill (oil constitutes 25 percent of imports), prolonged low interest rates which were used to import construction materials and overt consumption, large and growing middle class with a taste for imported goods, heavy infrastructure investments in the country, panic buying by importers, sell-off of shares by foreign investors at the Nairobi Stock Exchange, among other factors. He attributed the recovery of the shilling to the CBKs decision to raise the CBR rate to 18 percent, but also blamed this for current high lending rates and interbank lending rates. Equity Bank is one of the most capitalized Banks.

3.1.2 During their submissions to the Select Committee, Equity Bank Managing Director responded to the questions raised by the Committee regarding its participation in the interbank market, the Discount Window of the CBK, and whether the Bank had received any warning letters or other interventions from the CBK. The Managing Director reported the following regarding those issues:

- (i) That Equity Bank had not received any warning letters regarding its foreign exchange trading activities, the use of the Discount Window, or participation in the interbank lending market
- (ii) The Bank had also not been suspended from participating in the foreign exchange market, the use of the Discount Window, and participation in the interbank lending market,
- (iii) Equally, the Bank had not received any *ad hoc* visits from the CBK regarding the same matters and had not been subject to other regulatory interventions from the CBK.

3.1.3 The Bank further presented information and data showing the level of the Bank's participation in foreign exchange trading and foreign exchange exposure. Notably, the Bank argued that its foreign currency operations were negligible relative to the national foreign exchange reserves or the monthly import bill, which means that the Bank has limited capacity to influence the exchange rate. Between January 2011 and September 2011, the Equities Bank reserves ranged between US\$ 16.22 million to US\$ 49.98 million. Its reserves were about 0.01 percent of the reserves held by the CBK for the period January 2011 to September 2011. Foreign exchange trading income of the Bank had risen from Kshs 208 million in March 2011 to Ksh. 508 million in September 2011, but its proportion to the total operating income remained at about 3 percent during the same period. Even though Equity Bank is one of the largest Banks in terms of assets, the Bank reiterated that it was not a major player in the foreign exchange trading relative to other Banks whose foreign exchange trading could

represent 10 to 30 percent of their total operating incomes(see annex 8).

3.1.4 Responding to a question about foreign exchange trading for clients, the Bank argued that it does not participate in deal transactions, did not hold any major client accounts in foreign exchange, and therefore had not noticed any unusual fluctuations in foreign exchange trading volumes. The Bank however clarified that it held foreign exchange denominated funds (equivalent to Ksh. 14 billion) lent to Equity by several international institutions (for example the International Finance Corporation) at low interest rates for on-lending to local institutions involved in infrastructure developments. In fact Equity had extended foreign exchange denominated loans to a few institutions, such as US\$ 70 million to the KPLC. Transactions regarding these funds have minimal impact in weakening the shilling exchange rate since the funds are not exchanged to Kenya shillings, instead these funds would help strengthen the shilling.

3.1.5 The Managing Director refuted claims that he had in any way participated in any Government policy or given opinion to the CBK regarding the fall of the Kenya shilling. Instead, the Managing Director said that being the Chair of the Vision 2030, he often expressed his opinions regarding Kenya's development. He pointed out that his participation in this initiative could not give Equity undue advantage or influence in Government contracts since much of the information on Vision 2030 programmes is in the public domain, and further that his role in this initiative was not for profit but to be of service to the country.

3.1.6 The Bank also discounted the view that it was favoured in the awarding of Government contracts or Government funds to the Youth for example. Indeed, the Bank clarified that though it had received Ksh. 400 million from the Government for on-lending to target

groups such as the youth, it had always multiplied the amount it lends under this program (as required under the arrangement) at a low rate.

## Observations

- 3.1.8 It was however apparent that the Managing Director of Equity Bank, owing to his prominent role in financial services sector both locally and internationally, was closely associated with the Vision 2030, a Government Policy program with substantial impact on the direction of Government spending priorities. It is felt that sitting in such a commission could provide grounds for conflict of interest or cause disaffection among other Banks. It is therefore difficult to remove the tag that Equity Bank is favoured by the Government or is privileged if the CEO continues to advise Government through the Vision 2030 secretariat.
- 3.1.9 That despite the submission asserting that the Bank was a net lender to the interbank market, the Bank went to the Discount Window 14 times in 2010 and slightly over 50 times in 2011 (annex of Equity Bank) this is a contradiction to the claim that the Bank is a net lender and against the reasons for resorting to the window. The Bank borrowed from the Discount Window in excess of the stipulated guidelines of twice a week. It is evident that the Bank borrowed funds from the Discount Window despite its submission that it had not. The Bank was therefore not candid in its information to the Committee.

## Recommendation

- 3.1.10 From the foregoing, it is recommended that senior Banking officials in the country should be excluded from directly sitting in Government policy Committees or Government commissions to avoid conflict of interest, or to cause disaffection among other Banks.

## 3.2 Kenya Commercial Bank Limited

### Submission

3.2.1 The Committee met with the management of Kenya Commercial Bank (KCB) on 14<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) Political crisis in the Middle East and North Africa (MENA) countries resulted in a spike in the prices of oil internationally. Kenya's consumption of oil remained unchanged so the spike created a strain on the balance of payment and foreign currency requirements to pay for oil imports.
- (ii) The crisis in Egypt disrupted the tea auction since Egypt buys 30% of Kenya's tea thus reducing the foreign exchange to Kenya.
- (iii) There was a sell-off in the equities market globally and especially affecting emerging and frontier markets. Foreign investors also sold-off their shares at the NSE thereby putting more pressure on the Kenya shilling as the investors bought foreign currency.
- (iv) The CBK's reduction of the CBR rate early 2011 to 5.75% may have increased credit expansion and increased demand for imported goods.
- (v) Drought in Kenya had an effect on food and hydroelectricity production. So the country had to import food and more oil for power production increasing demand for foreign currency (see annex 9).

### Observation

3.2.2 Upon interrogation of the KCB management, the Committee made the following observations:

- (i) That the CBK's intervention in the market was long overdue
- (ii) There was capital flight in the economy and this could have been an additional cause of the decline of the Kenya shilling
- (iii) The Bank denied involvement in any speculation stating that it participates in the foreign exchange market according to rules and regulations in place.

- (iv) The Bank has always held capital in foreign assets at below the maximum limit of the CBK even before the regulator revised the limit downwards.

### 3.3 Cooperative Bank of Kenya Limited

#### Submission

3.3.1 The Committee met with the management of Cooperative Bank of Kenya on two occasions, 14<sup>th</sup> December 2011 and 25<sup>th</sup> January 2012. In the meetings, the Committee was informed that the some of the causes of the fall of the Kenya shilling include the presence of a wide current account deficit, building of reserves by CBK, and servicing of external debts. The reasons for the wide current account deficit were:

- (i) Large and growing imports bill due to: high dependency on oil imports whose international prices are unstable, increased importation of second hand cars which have caused an increase in fuel consumption, importation of foodstuff due to drought, importation of non-essential commodities, increased importation of machinery and equipment for ongoing constructions, among others.
- (ii) Stagnant supply of foreign currency due to the following: reduced earnings from sale of tea, coffee, horticulture due to the financial crisis in the European Union and political instability in the MENA region which are our main trading partners; and, reduced remittances from the Diaspora.

3.3.2 In the presentations, Cooperative Bank proposed the following to the Committee that could help in mitigating the problem of the depreciation of the shilling:

- (i) The country should develop initiatives to mitigate the import bill in the following areas:

- Encourage more fruitful local production of food and use it to enhance strategic food reserves
- Develop Government policies to hinder importation of non-essential commodities and mass importation of second hand cars
- Enhance Government investments in renewable energy (see annex 10).

### Observation

3.3.3 The Committee instructed the Bank to furnish information on a number of interactions the Bank had with the CBK during the period when the shilling was in a crisis and the shareholding of the Bank. The committee established the following from the Cooperative Bank management:

- (i) That the Bank did not receive any warning letters from the CBK regarding their foreign exchange trading, use of the Discount Window of the CBK and participation in the interbank market.
- (ii) The Bank was not suspended from the foreign exchange market, Discount Window of the CBK and participation in the interbank lending market.
- (iii) The Bank received a team of two CBK staff who carried out an onsite review of their foreign exchange trading activities but the Bank did not receive a formal report of the review.
- (iv) That the Bank has a total of 13 directors who holds 4% shareholding in the Bank; 7 of the directors were elected by the cooperative holding society, 2 are elected by the ordinary share holders, 1 is the commissioner of cooperatives, 1 is the representative of the Permanent Secretary in charge of Treasury and 1 is the Managing Director of Cooperative Bank of Kenya.
- (v) The Bank stated that there was no staff sacked during the period of June to December 2011. The only staff that left during the period retired voluntarily.
- (vi) That the Kenya Cooperative Coffee Exporters Ltd is not owned by Cooperative Bank though some of the export company's

directors were also directors in the Cooperative Bank board. These directors were elected by the coffee farmers who are shareholders in both companies (see annex 11).

- (vii) It was further observed that this company is owned whole by cooperative farmers and so there is no evidence to connect them with any malpractices related to foreign exchange trading.
- (viii) The Bank admitted to have seconded two of its staff to the Kenya Cooperative Coffee Exporters Ltd for technical support in administration of the Company.
- (ix) The Co-operative holding society held 65% of the total shares of the Bank while the remaining 35% shares are held by investors through the Nairobi Stock Exchange. Of the 35% shares held by investors at the NSE, 4% are held by the Bank directors. The Committee noted that the information was publicly available.
- (x) That some of the directors of the Bank sold their shares of the Bank in the NSE including the MD of Cooperative Bank who had sold one third of his shares in the Bank (approximately worth Kshs.320 Million in the course of the year 2011). However, these sales were not related to the volatilities of Kenya's shilling exchange rate.
- (xi) That the Bank operates on a foreign currency limit of approximately 3.5% against a foreign exchange exposure limit of 20% (10 % after review of foreign exchange exposure limits).

## Recommendations

3.3.4 Based on the submissions by the Cooperative Bank management, and the fact that the Bank maintains a very low foreign exchange exposure, the Committee found no information to show that the Bank had committed any malpractices regarding trading in foreign exchange.

### 3.4 CitiBank limited

#### Submission

3.4.1 The Committee met with the management of Citibank on 19<sup>th</sup> December 2011. The management team of the Bank outlined before the Committee the causes of the fall of the Kenya shilling as follows:

- (i) Perceptions about Kenya's forthcoming elections and rising political activity may have caused jitters in the foreign exchange market.
- (ii) The global economy was also in turmoil and passing through uncertain times. There was a steady increase in the demand of foreign currencies.
- (iii) The loose monetary policy was a major cause since the interest rates were extremely low and the inflation rate was high making it unattractive to hold assets in shillings, hence the huge demand for foreign currencies.
- (iv) Strong economic growth and fiscal spending continued to suck in imports, widening the current account deficits.
- (v) The depreciation was accelerated by a sharp rise in inflation in early 2011 caused by poor rains against a background of rising food prices and fuel prices.
- (vi) When the shilling started to weaken, modest speculative flows increased the pace for depreciation as the CBK seemed not to have an appetite to intervene in the market.

#### Observations

3.4.2 From the interaction with the management of Citibank, the Committee observed the following:

- (i) That the CBK's delayed intervention could have been a major contributing factor of the sharp depreciation of the shilling.
- (ii) The Bank's foreign exchange trading was questionable since it received 2 letters from CBK for inspection and the CBK made four

- (4) unscheduled visits to the Bank upon which the regulator inspected the foreign exchange trading by the Bank.
- (iii) The Bank did not access the interbank lending window during the period of the fall of the shilling since it was liquid enough.

## Recommendations

3.4.3 The Committee observes that the Bank had increased amount of trading in foreign exchange, probably well within the legal limits (at that time, the foreign exchange exposure limit was 20% of core capital) at the time. However, the Committee recommends that the CBK should increase its monitoring tools to ensure that excessive trading in foreign exchange does not affect the general stability of the shilling.

## 3.5 Family Bank Limited

### Submission

3.5.1 The Committee met with the management of Family Bank on 14<sup>th</sup> December 2011 and 25<sup>th</sup> January 2012. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) That the core problem facing the economy was supply side inflation. The Bank observed that Kenya's population has been rising while local production of essential goods can hardly match the demand, leading to rising imports. The export earnings from the country also cannot support the needed imports thus creating a current account deficit. This causes an increase demand for foreign currencies.
- (ii) High dependency on rain-fed agriculture also affects availability of food locally making the country resort to importation. The country's export market is dominated by agricultural produce and a shift in the rain pattern affects production. Increased import of food increases demand for foreign currency.

- (iii) The slow action by the Government and specifically the CBK could also have been a caused since it failed to arrest the inflation problem early enough.

3.5.2 To address the problem of the shilling exchange rate, the Bank proposes the following:

- (i) The country should manage its food security situation by developing agricultural policies to encourage irrigation agriculture and modernized agricultural practices. Also agricultural lands should be protected and housing projects be directed deliberately towards semi-arid areas unsuitable for agriculture.
- (ii) The country should also invest in renewable energy and reduce overreliance of rainfall relied hydroelectricity and the expensive thermal energy.
- (iii) The country should also learn from the Euro zone on the effects of uncontrolled debt since Kenya presently has a huge debt and is paying a lot in interest. This is consuming quite a chunk of the foreign currency.
- (iv) The Bank also noted that the exchange rate still remains vulnerable to depreciation until the primary drivers of the depreciation such as huge current account deficit are addressed.

3.5.3 On whether the Bank had received any warning letters, ad hoc visits by the CBK, suspension from the interbank market, or had been subject of other regulatory interventions, the Management of Family Bank clarified the following:

- (i) There were unscheduled visits to the Bank by CBK officials who came to review their foreign exchange trading activities but no formal report was presented to Family Bank concerning the visit. The Bank reported to have no problem with its ratios (see annex 12).

- (ii) That the Bank went to the CBK Discount Window three times in a week, against the maximum 2 times stipulated in the new CBK guidelines, thus inviting steeper or punitive interest rates on such borrowing. The Bank used the window due to prevailing liquidity problems in the Banking system following CBKs measure to raise the CBR.
- (iii) With regard to the foregoing, the Bank noted that it was not easy for small local Banks to obtain funds from the interbank Bank market during the time of the liquidity crunch since they did not have credit lines with the Banks with liquidity. Hence, the Banks went to the CBK which is a lender of last resort.
- (iv) The larger Banks and those with excess liquidity often mark credit lines with other Banks on the basis of risk management practices among other policies. Thus, the interbank market is not essentially a purely fair market.
- (v) The Bank also noted that small local Banks faced very expensive branch network, maintained a larger customer base, and therefore faced higher operating costs.

## Observation

3.5.4 The Committee noted that the interbank market was not working efficiently particularly after the liquidity problems that followed the spike in the CBR rate in November to December 2011. Specifically, the market is far from perfect: small Banks face expensive borrowing in the interbank market and when those funds are unavailable, the only option is to go to the CBK Discount Window for funds at punitive interest rates. The Committee notes that Banks cannot at times obtain credit from the Banks with liquidity if they do not maintain credit lines. The larger Banks and those with excess liquidity often mark credit lines with other Banks on the basis of risk management practices among other policies. The Committee also observes that the seamless and efficient operation of the interbank market and the Discount Window are critical for the stability of the financial sector and the

transmission of monetary policy decisions. What then can be done to make the market more flexible and efficient?

3.5.5 The Committee observes that the management of Family Bank was quite candid and honest with the Committee regarding most of the issues sought.

### Recommendations

3.5.6 The CBK should use necessary tools and work with Banks to improve the operations of the interbank market so as to insure against unnecessary liquidity problems and unnecessarily high interest rates.

## 3.6 Barclays Bank of Kenya Limited

### Submission

3.6.1 The Committee met with the management of Barclays Bank of Kenya on 14<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) Kenya is a net importer, that is, Kenyans consume a lot of imported goods. Excessive imports of goods coupled with an increase in global prices of commodities like oil piled more pressure on the local currency to depreciate.
- (ii) Drought and sporadic rainfall in early 2011 saw a reduction in food production and increased importation of food commodities. This increased the current account deficit.
- (iii) Due to the debt problems and slow growth in the European Union and US, foreign investors sold off shares at the NSE to address shortfalls in their incomes in their home countries. This caused a heavy demand for foreign currencies.

3.6.2 From the interaction with the management of Barclays Bank of Kenya, the Committee observed the following:

- (i) The Bank did not undertake any speculative trading positions. All currency purchased and sales were supported by underlying customer orders.
- (ii) The Bank's foreign currency levels were between US\$230 million and US\$340 million during the year 2011, but generally showed an increasing trend though there was a slight peak during the month of March and July (see annex 13).
- (iii) The response by the CBK to increase the CBR rate to 11% and eventually 16.5% caused the Banks to increase their base lending rate. This has made the cost of borrowing high.

## Observations

3.6.3 The Committee observed that Barclays Bank is one of the largest holders of foreign currency, holding foreign currency in excess of Ksh. 26 billion. However, the Committee found no evidence of any trading malpractices by the Bank.

## 3.7 CFC Stanbic Bank

### Submission

3.7.1 The Committee met with the management of CFC Stanbic Bank on 16<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) Huge import bill and low exports due to massive importation of machinery and equipment to the country for infrastructural development increased the demand for foreign currency. Drought also led to increased food imports but decreased exports of agricultural produce. Other factors that affected the export markets include: the Arab uprising in the Middle East which is a major export destination for Kenyan tea, and Europe debt crisis which is a major destination for Kenyan horticulture and floriculture market.

- (ii) With the shilling weakening, importers panicked and bought foreign currencies in advance to facilitate for their future importation while individuals and Banks with speculative tendencies held on to their foreign currencies with the aim of making profit from the situation.
- (iii) The increase in the international price of fuel could have been a cause since Kenya is a net importer of fuel and the demand did not decrease even with an increase in prices.

3.7.2 The Bank representatives observed that Kenya lacked a clear institution to regulate the foreign exchange trading market and the Kenyan foreign exchange trading was done on a supply and demand basis. Once the shilling had shown signs of weakening, speculative behavior set in, acting as the major catalyst of the depreciation given that Kenyan foreign exchange trading is an open system.

3.7.3 Following queries by the Committee, the Bank admitted to have received unscheduled visits from the CBK to inspect its foreign exchange trading. The CBK found out that the Bank had flouted some regulations and the Bank was suspended from the interbank exchange window (see annex 14).

### Observations

3.7.4 CFC Stanbic Bank is one of the Banks with large foreign exchange holdings which mean that it had significant impact in the foreign exchange market. From information available, the Banks trading appear to have been within the required limits until the CBK placed new guidelines on foreign currency swaps. The Bank suffered suspension from the interbank market for 30 days and was fined Ksh. 1 million for flouting a new guideline issued by the CBK on 13<sup>th</sup> October, 2011 on the tenor of foreign currency swaps.

3.7.5 The Committee notes that since the interbank market is regulated by Kenya Bankers Association, there is no adequate intervention to

control abuse of market power by big players. Also, the penalty for flouting regulatory guidelines is very light relative to the potential economic cost of the malpractice. The penalties could be enhanced.

## Recommendations

3.7.6 The Committee is of the view that Banks could have made a lot of money from foreign trading which also contributed to the fall of the shilling. Given that part of this trading is within legal limits, the Committee recommends the reduction of opportunities for such trading through CBK monitoring and also enhancement of penalties for flouting the regulations. The monetary penalty on breach of a regulation should be proportionate to the value to the Bank of the malpractice at the given time. In the wake of the magnitude of the fall in value of the shilling, the Kshs. 1 million penalty on the Bank could be only a very small fraction of the gains made by this Bank. Therefore, the penalty should be revised upwards to be commensurate of the value to the Bank of the malpractice.

## 3.8 Housing Finance Company Kenya Limited

### Submission

3.8.1 The Committee met with the management of Housing Finance Company Limited, on 14th December 2011. The Committee was informed as follows:

- (i) The weak shilling affects the housing sector due to high cost of imported construction materials. Kenya imports raw material and equipment for construction in the housing sector and the weakening of the shilling caused these imports to be costly.
- (ii) Remittances from the Diaspora helped offset reduced investment in housing associated with the weakening shilling.
- (iii) The Managing Director also regretted that the irregularly acquired titles in places such as Syokimau and other parts of the country

could increase default rates in future. About two clients had their houses demolished in Eastleigh area of Nairobi.

### Observation

3.8.2 The Committee observed that as a result of the increasing in CBR rate to 18%, Banks arbitrarily increased their lending rates on existing loans to between 24% and 32%. Further insider knowledge played a part during the period of the crisis with Banks raising the interest rates way before the rise in the CBR rate.

## 3.9 Standard Chartered Bank Ltd

### Submission

3.9.1 The Committee met with the management of Standard Chartered Bank on 6<sup>th</sup> February 2012. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- i) Macroeconomic instability in both the local and global economy. The international economy was facing tough times while internally, the country was facing a high inflation regime, a wide current account deficit, and increasing budget deficit.
- ii) The fall of the Kenya shilling was preceded by a period of low interest rates caused by an expansionary monetary policy. High liquidity in the financial sector contributed to cheap credit that fueled domestic consumption. A bigger proportion of the borrowing was used to finance consumer demand rather than corporate investments. Part of consumer spending was geared towards imported goods which further worsened the difference between exports and imports and the current account deficit. Thus, the growth in domestic credit did not therefore fully lead to increased production in the country.
- iii) Uncertainties about the direction of the Kenya shilling exchange rate caused widespread panic among market players such as importers and exporters. The expectations were that the shilling

could slide further, and this caused exporters to hold their foreign currencies positions while importers bought foreign currencies to cushion their planned future importation. The importers could have even borrowed from the Banks due to the cheap credit so as to buy the foreign currencies.

3.9.2 On whether the Bank had received any warning letters, ad hoc visits by the CBK, suspension from the interbank market, or had been subject of other regulatory interventions, the Management of Standard Chartered Bank clarified the following:

- (i) That the Bank did not receive any warning letters from the CBK regarding their involvement in the foreign exchange market, the CBK's discount lending window or the interbank window.
- (ii) That the Bank did not borrow from the Discount Window at the time that Banks were accused of involvement in arbitrage. The Bank further clarified that it was never involved in arbitrage.
- (iii) The Bank was never suspended from participating in the interbank market or the CBK's Discount Window.
- (iv) The Bank did not receive any ad hoc visits from the CBK regarding its participation in the foreign exchange market during the period when the shilling was depreciating.
- (v) The Bank only holds foreign exchange on behalf of its clients and not for foreign exchange trading purposes or speculation. Thus, the buildup of the foreign exchange balances was due to individual customer holdings of foreign currencies.

## Observations

3.9.2 From the interaction with the management of Standard Chartered Bank, the Committee observed that maintaining of an expansionary monetary stance with the inflation rate going up could have been a major cause of the fall of the Kenya shilling. The CBK interest rate at some point was as low as 6 percent when inflation was 10 percent. This situation would definitely encourage arbitrage.

3.9.3 Though the Bank in its submissions before the Committee denied that it had received letters and ad hoc visits by the CBK, evidently the correspondence between the CBK and Standard Chartered Bank demonstrates that the Bank was one of those inspected by the CBK. Correspondence between the CBK and the Bank revealed that CBK officials visited the Bank to carry out related investigations. Clearly the Bank was not honest with information.

### Recommendation

3.9.4 The Commercial Banks took advantage of the frequent upward revision of the CBR rate and increased their lending rates without proper cause and notification thus hurting the borrowers. This should be reduced to preempt an eminent rise in default rate (see annex 15).

## 3.10 Kenya Bankers Association

### Submission

3.10.1 The Committee met with the CEO, Kenya Bankers Association, on 15<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) There was an increase in the world fuel price and since Kenya is a net exporter, this worsened the current account deficit.
- (ii) The Euro zone debt crisis worsened the situation with the capital flight by investors to US dollars which was deemed to be a safe haven. This made the dollar appreciate against most currencies.
- (iii) The private sector credit had risen faster than economic activity implying that credit expansion was financing more of consumption than productive economic activities. This exerted inflationary pressures from the demand side which needs to be contained by monetary policy.
- (iv) The depreciation was further worsened importers and exporters who went into panic buying of foreign currencies for their future

needs in anticipation of a weakened shilling. Speculators also came into the market creating a shortage of foreign currencies.

#### 4.0 SUBMISSIONS BY ECONOMIC EXPERTS

##### 4.1 Dr. David Ndi

###### Submission

4.1.1 The Committee met with Dr. David Ndi on 8<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) The instability of the shilling had two drivers, the underlying causes and the trigger. The underlying causes were to do with fiscal and monetary policies and the trigger was the Euro zone crisis.
- (ii) The pressure on the shilling could be traced back to the fiscal stimulus packages announced after multiple economic shocks namely, post-elections violence, drought and global financial crisis in 2008/09 financial year. The fiscal stimulus was rolled out in the 2009/10 and 2010/11 budgets.
- (iii) The CBK also supported a monetary stimulus by creating an accommodative monetary stance similar to that of monetary authorities all over the world. The benchmark 91-day Treasury bill rate was driven downwards from 7% in November 2009 to a low of 1.6% in July 2010, and kept below 3% until the middle of 2011.
- (iv) The stimulus, both fiscal and monetary, enabled importation of capital and consumer goods, in effect causing the widening of the trade deficit. The widening trade deficit and excessive cheap credit created an opportunity to speculate against the shilling.

## Observation

4.1.2 From the interaction with Dr. David Ndi, the Committee observed the following:

- (i) The fiscal stimulus programme should have been rolled back in 2010/2011 since it was evident that the economy was more resilient to shocks and the country had been recovering strongly.
- (ii) The monetary stimulus was imprudent since the Banking sector was strong and stable. The CBK should have waited to see the impact of the fiscal stimulus first before acting to expand money supply.

## Recommendations

4.1.3 The Committee finds that the CBK may have been overenthusiastic about economic stimulus and also maintained the low interest rate regime for far too long. The Committee therefore recommends that the CBK should maintain a coherent monetary policy at all times with a focus on price stability. This is the key objective of the CBK. Other goals should be secondary.

## 4.2 Micah Cheserem – Former Governor of the CBK

### Submission

4.2.1 The Committee met with Mr. Cheserem on 6<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) There was a deteriorating current account deficit. This was due to food shortages and fuel price increases that caused increased importation and a surge in the demand of foreign currencies.
- (ii) The move by the CBK to purchase foreign currencies from the market to strengthen its foreign exchange reserves when the shilling had already started deteriorating created a window for speculators to start hoarding the foreign currencies.

- (iii) The pronouncement by the CBK that it would not intervene in the market worsened speculative activity and the shillings continued with its free fall.
- (iv) Purchase and repatriation of foreign currencies by foreign and local investors since the Treasury bills had very low interest rates compared to overseas interest rates.

4.2.2 From the interaction with Mr. Cheserem, the Committee observed the following:

- (i) The CBK could only be responsible for managing underlying causes which are subject to monetary policy while all other causes are outside the control of the CBK.
- (ii) The CBK had capable economists yet it allowed an expansionary regime of money supply to persist for long.
- (iii) The CBK's move to mop up liquidity then pump it in again within a short time sent mixed reactions to the public.
- (iv) The CBK's public pronouncement of its intentions to intervene or not in the market sent mixed signals to the players in the market (see annex 16).

4.2.3 On his part Mr. Cheserem suggested the following measures for consideration to address the problem of the exchange rate:

- (i) The CBK should maintain a high but not too excessive CBR rate that would not damage the economy.
- (ii) The Government should put austerity measures to reduce borrowing from the market. This will ease the interest rates.
- (iii) The CBK Governor and Deputy Governor should be appointed through a competitive process.
- (iv) The CBK should be required to appear before an appropriate Parliamentary Committee on a regular basis to explain the performance of their two core mandates of price stability and financial stability of the Banking system.

## Observations

4.2.4 As a former CBK Governor, Mr. Cheserem submissions were quite useful. Firstly, the Committee notes the importance of strengthening the operational structure of the CBK including the need to recruit the top officials such as the Governor and Deputy Governor competitively. More important is the need to ensure that the management of CBK is answerable to the Kenyan public not only through the executive but also through an appropriate parliamentary Committee.

## Recommendations

4.2.5 From the foregoing, and to strengthen the governance of the CBK, the Committee recommends that the CBK Governor and Deputy Governor be recruited through a competitive process. The Committee also recommends that the CBK Act should also be amended to provide the CBK Governor appears before a relevant Parliamentary Committee of the National Assembly on a regular basis to explain the performance of CBK concerning the core mandates of price stability and financial stability. In addition, there ought to be put in place a mechanism that guarantees oversight over the CBK by a parliamentary Committee.

4.2.6 Amend the law to review and restructure the composition, selection process and qualifications of members of the Monetary Policy Committee.

## 4.3 Dr. Thomas Kibua – Former CBK Deputy Governor

### Submission

4.3.1 The Committee met with Dr. Kibua on 1<sup>st</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) The world economic situation was deteriorating with America and the Euro zone both in a debt crisis. The Middle East and North Africa countries were having political instability. Since most of these countries are trading partners with Kenya, there was a drop in the earnings from export causing a current account deficit.
- (ii) The country was facing supply constraints; inadequate food supply and rising fuel prices. This increased the import bill creating a current account deficit.
- (iii) The actions of the Government in 2011 were equivalent to fiscal indiscipline. The economic stimulus programme, women development fund and youth development fund had become unproductive since the money spent was not equal to the output. This money found its way to consumption rather than development.
- (iv) The CBK had created an environment of weak monetary policy, creating excess liquidity, rise in credit to the private sector, and inflation. This money increased inflation and could have been used for speculation. With the drop in the interest rates, many Kenyan decided to transfer their money into foreign currencies with the aim of speculating since the returns would be more lucrative than investing it. This even caused divesture since people needed their money in foreign currencies. Speculative activities of individuals and Banks made them to hoard foreign currencies with anticipation that prices would go up.
- (v) There had been heightened political temperatures with the coming of an election year and the ICC cases debate. Investors were divesting and foreigners were withdrawing their stakes in shares at the Nairobi Stock Market.
- (vi) There was a drop in the inflows from export and remittances from the Diaspora. Many of the external investors felt Kenya was unstable.
- (vii) The actions and omission from the CBK were a clear cause of the problem. The CBK should ensure that the market is stable. Once the CBK sent mixed signals in the market, speculators positioned

themselves to take advantage of the reactions. The CBK also did not engage the commercial Banks early enough but it tried to compete with them yet it should be their regulator, not competitor.

4.3.2 From the interaction with Dr. Kibua, the Committee had the following recommendations to address of the Kenya shilling:

- (i) Legislation should be put in place to discourage conspicuous consumption like importation of non-essential goods and basic commodities available locally.
- (ii) Fiscal discipline: The Treasury should develop good macroeconomic financial programs to guide the economy. There should be value for money from all Government expenditures. The Government should prioritize public projects in a manner in which the economy doesn't overheat.
- (iii) The CBK should be in control of the financial market as a regulator. Since there is a clear problem of cartels in the market, the CBK should address this through its Bank supervision department.
- (iv) The CBK should be clear with its stand and should not send mixed signals in the market. The CBK should be up-to-date with the market operations of the Banking industry since its timely interventions could save the country from a similar economic downturn.
- (v) The independence of central Bank should be upheld and the institution should know its responsibility and the consequence of not undertaking its duties diligently. The Government should stop frequent interferences with its CBKs operations.

#### Observations

4.3.3 The Committee notes that the CBK may have lost control of the financial markets during the time of the exchange rate crisis and was not up-to-date with the market operations of the Banking industry

which could have slowed down its response to the crisis. While the independence of the CBK is paramount, the CBK should execute its mandates effectively and there should be sanctions for failure to do so effectively.

## Recommendations

4.3.4 From this observation, the Committee recommends that an external organization carries out an internal audit of what went wrong in monetary operations and Bank supervision with a view to rectifying the problem. The Committee also proposes amendments to the CBK Act to provide for punitive measures on the Management of the Bank for gross failure in attainment of important monetary policy objectives or failure which occasions the country huge losses.

## 5.0 OTHER STAKEHOLDERS

### 5.1 Foreign Exchange Dealers Association

#### Submission

5.1.1 The Committee met with a representative of the Foreign Exchange Dealers Association, on 15<sup>th</sup> December 2011. The Committee was informed that the causes of the fall of the Kenya shilling were as follows:

- (i) The ICC decision on the "Ocampo six" led to uncertainty on Kenya's political climate and any foreign investor started divesting and taking up foreign currencies as a safe haven increasing the demand for foreign currency.
- (ii) The drought that hit parts of the country affected export produces like tea and coffee causing a reduction in their production. This reduced the country's exports while import bill was rising therefore widening balance of payment. This, compounded by the fact that one of Kenya's major tea export

- market, Egypt, was in a political crisis significantly reduced the income from tea exports.
- (iii) The turmoil in North Africa and the Middle East caused uncertainty in the international oil market. Prices had risen to over \$100 per barrel. IMF World Economic Outlook forecasts for 2011 were \$85.50 per barrel. Oil imports constitute over 25 per cent of Kenya's current account. Thus the increase in prices increased the import bill directly.
  - (iv) The NSE had lost 446 points since January 2011 —about 10 per cent. The foreign component of this directly affects the demand and supply of US dollars, which directly affects the USD/KES price.
  - (v) Speculative behaviour may have been responsible for the problem with shilling, but speculation is standard market behaviours in domestic and international markets. Like in the case of NSE stock trading, dealers in foreign exchange are in the market to trade and speculate since this is the way they make money.
  - (vi) With all the fundamentals causing jitters in the foreign exchange market, the CBK failed to acknowledge the facts and instead dismissed them as short term in nature or supply side shocks.
  - (vii) Treasury implemented the Economic Stimulus Programme (ESP) while the Central Bank implemented an accommodative monetary policy. The CBK reduced the CRR and the CBR so as to encourage Banks to lower their lending rates and make credit cheap. This policy made the market liquid, making it possible for the Treasury bills and Treasury bonds interest rates to fall drastically and making it easy for the Government to borrow. The interest rates were below inflation rates. The Government started undertaking massive development projects and there was need to import major construction materials. Furthermore, the country was facing drought and it embarked on importation of food. The cheap credit went into importation of second hand

vehicles, non-essential goods and basic foodstuff. All this added to a growing import bill.

5.1.2 In its sittings the Committee also heard from the Foreign Exchange Dealers Association that:

- (i) That the long-term structural problems in Kenya's economy, including the ratio of exports to imports, high cost of crude oil in the past ten months besides drought had sparked inflation and also the depreciation of the local currency.
- (ii) The built up of the Central Bank foreign currency reserves, mainly from actual purchases of USD from the market, from 2008 to early 2011 reduced the amount of foreign currency in the market.
- (iii) When the crisis was at its onset, the signals from the CBK to the market were creating more confusion in the market. For example, its failure to intervene caused panic buying by importers and increased speculation. The Central Bank did not inject its foreign currencies to the market early enough.

### Observations

5.1.2 The Committee notes that while foreign exchange trading and taking positions within legal limits is not illegal, the CBK should be in a position at operational level to devise tools and regulations and guidelines to ensure stability in the foreign exchange market and to curb excessive trades that may drastically affect the direction of the shilling.

### Recommendations

5.1.3 The Committee recommends that the CBK should focus on ensuring the efficient operation of the foreign exchange market and respond in a timely manner to major fluctuations in the exchange rate. The guidelines to curb unusual and illegal trades should be deterrent.

## 5.2 Kenya Private Sector Alliance (KEPSA)

### Submissions

5.2.1 The Committee met with the Kenya Private Sector Alliance, on 8<sup>th</sup> December 2011. The Committee was informed as follows:

- (i) It is important to have an improved and efficient infrastructure to the growth of the economy. There is a need to have policy guidelines on how the projects towards infrastructural development are implemented. There should be a mechanism to look into the mega projects and their execution processes.
- (ii) That the cost of running the Government is too high putting pressure on the scarce resources. The overall budget is widening due to both an increase in the development and recurrent expenditures. The revenue collected is not growing enough to counter the recurrent expenditure and there is need for reforms to manage it. With the enactment of the constitution and the implementation of the Vision 2030, there has been increased development expenditure so as to deliver the required conducive environment to the Kenyans. This is in the backdrop of a not so good performing revenue collection. So the Government has to resort to borrowing both from the internally and externally increasing the public debt and the amount of interest to be paid.
- (iii) The increased cost of goods is partly caused by inefficiency in production which is then passed on to the consumer.
- (iv) There is need to harmonize companies involved in energy supply and target tariffs to avoid competition in the energy sector.
- (v) The Central Bank of Kenya Governor chairs the MPC as the policy making organ and he is also the implementer. The nomination of the members of the MPC is also shrouded in secrecy hence bringing in the suspicion.
- (vi) Foreign funded projects are not fully paid for and the Government has to buy foreign currencies to pay for its part. In light of the

- increase in the number of such projects, this raises the demand for the foreign currencies hence pushing inflation further up.
- (vii) The Central Bank should have a working relationship with Banks and other foreign exchange dealers in order to share information. Competition in the foreign exchange markets and other money markets should be encouraged so as to limit cartels.
  - (viii) Government projects should be sub-let to local contractors to reduce the demand for foreign currency. Any foreign contractor should work in conjunction with local contractors so as to enhance knowledge transfer.
  - (ix) The Government should identify what can be imported for the projects and what should be produced locally. That is, need to look at the ratio of inflow and outflow in the projects. Some machinery from local companies should be used to avoid using foreign currencies to import machinery which are locally available. Since most of the development is in preparation for the devolved Government, this should be effected in phases for cost efficiency and to maintain stability.
  - (x) Energy cost is an issue in the country and should be addressed effectively. The efficiency of Kenya pipeline as well as the entire supply chain should be improved to cut on energy cost. The harnessing of coal should be fast-tracked to enhance development of power in a different way. It should also be fast-tracked so as to cut on the energy costs incurred through importation.
  - (xi) Infrastructure efficiency and capacities should be improved by giving incentives to companies whose vehicles reduce congestion on the roads, such as double-decker buses.
  - (xii) The education sector should set up standards of education to be able to supply the region with skills needed for efficiency as well as enable Kenyans acquire international contracts as a way of earning foreign currency.
  - (xiii) The Kenya Tourist Board should promote education tourism to boost the economy.

- (xiv) That the import storage facility in Mombasa needs to be commissioned to cut on the additional costs imports incur at the store.
- (xv) An independent Commission to monitor Central Bank should be formed.

### Observations

5.2.2 The interaction with the Kenya Private Sector Alliance outlines many public policy issues of broader economic interest than the issue of Kenya shilling. The Committee mainly observes the need for accountability in Government and coordination of economic policy making with other agencies so as to have a uniform way to deal with and to avoid economic crisis such as that of the fall of the Kenya shilling.

5.2.3 The Committee also noted the need to divide the roles of CBK policy making and oversight of the Banking industry. Currently the nomination and appointment to the MPC is shrouded in secrecy. This suggests the need to give some level of autonomy to the Bank supervision wing of the CBK. Additionally, the selection and composition of the MPC should be open or competitive so as to strengthen the role of monetary policy making and accountability (see annex 17).

### Recommendation

5.2.3 To improve the effectiveness of CBK the Committee recommends that a review of the CBK structure be done to suit the viability of increasing the autonomy of the CBK policy making organ and the oversight or supervision of the Banking system.

### 5.3 Consumers Federation of Kenya

#### Submissions

5.3.1 The Committee met with the Consumer Federation of Kenya, on 6<sup>th</sup> December 2011. The Committee was informed as follows:

- (i) Owing to the devaluation of the Shilling against major currencies, the cost of living of Kenyans has sky rocked and consumers are not able to access basic needs due to the high cost of commodities.
- (ii) Imports have become expensive making them unaffordable.

## 5.4 Institute of Economic Affairs (IEA)

### Submissions

5.4.1 The Committee met with the Institute of Economic Affairs, on 1<sup>st</sup> December 2011. The Committee was informed as follows:

- (i) A rise in interest rates tends to contract the economy by appreciating the currency and reducing net exports. On the other hand a decline in interest rates tends to expand the economy by depreciating the currency and raising net exports.
- (ii) Fiscal policies often affect interest rates and international capital flows to Kenya. For example, fiscal expansion pushes up interest rates. At higher interest rates, Kenyan securities become more attractive to foreign investor, which appreciates the shilling.
- (iii) Contradictory monetary policy reduces aggregate demand, which lowers both real GDP and prices. A monetary contraction raises interest rates; hence a tighter monetary policy attracts foreign capital into Kenya in search of higher rates of returns. The exchange rate therefore rises.
- (iv) Kenyan exports were dampened due to the euro zone crisis since Europe is a big consumer of Kenyan products
- (v) The Institute recommended the tightening of monetary policy.

## 6.0 POLICY RESPONSES

6.1 The signs that the Kenya shilling exchange was facing sustained fall due to the current account imbalances and rising inflation was apparent as early 2011. Nevertheless, the CBK still resisted calls to intervene instead, the Monetary Policy Committee of the Central Bank of Kenya maintained the CBR rate flat (minimal changes were made in May to July 2011) unchanged from February 2011 to September 2011 despite the fact that both inflation and depreciation of the Kenya shilling was rising at alarming rates. Clearly, there was a major policy lapse given that policy action from the CBK should have come as early as March 2011. Various belated measures were, however, implemented by the CBK and the Ministry of Finance to stem the fall of the shilling.

6.2 The Ministry of Finance took the following steps to deal with the fall of the Kenya shilling:

- (i) The Ministry of Finance for example sent circulars to all Government departments to reduce unnecessary expenditure such as those on foreign travel and furniture. These were meant to address Government's demand for foreign exchange and also to curb inflationary pressures. Treasury reported that it had made savings amounting to about Ksh. 5 billion owing to these measures alone.
- (ii) The Ministry of Finance also reported that the Government had changed its macroeconomic framework to reduce the amount of budget deficit by 1 percent by end of 2012.
- (iii) The Ministry also sought and received an extension of the Extended Credit Facility (ECF) from IMF. Given that the fall of shilling was largely driven by balance of payments problems, the Government sought support from the IMF under the Extended Credit Facility to shore up the local currency and ensure that the country's balance of payments remained stable. The country has since accessed amounts exceeding USD 300 million since early

2011, and could access additional funds under the three year ECF program.

(iv) Treasury's action to curb non-essential imports could do something to address the huge import bill, but this needed permission from EAC partner states to change any tariffs on imported products.

(v) In addition, CBK, Treasury, Banks or their representatives, the Kenya Bankers Association, and a Task force in OPM held various consultations which improved communication between CBK and Banks and also helped coordinate the response and also manage expectations.

6.2 The CBK responded to the early problem of arbitrage by increasing restrictions on the use of the Discount Window. It is believed that Banks were using the Discount Window to access funds to invest in the Government securities instead of using their dollar holdings. This therefore reduced dollars available in the foreign exchange markets. Following are the primary responses that the CBK took:

- (i) The CBK injected US\$ 118.25 million in the market between July and November 22, 2011. Given that the Bank also bought foreign currency from the markets amounting to USD 95.8 million, the net injection was small and could not have reversed the direction of the Kenya shilling. The intervention through the sale of foreign exchange was limited by the amount of reserves available in Kenya.
- (ii) The CBK also reacted by lowering the foreign exchange exposure limit of Commercial Banks from 20% to 10%: This measure served to make foreign currency more readily available and therefore cheaper (in relation to Kenya shilling) by forcing Banks to hold less foreign currency assets, which also reduces foreign currency dealings and speculation.
- (iii) Successive increments in the CBR rate and the Cash reserve ratio to reduce money supply: The most significant policy response

came in October 2011 when the CBK raised the CBR to 11 percent. Early the next month, the CBK again raised the CBR to 16.5 percent, resulting in sharp strengthening of the shilling from the peak Ksh. 107 to the US dollar to Ksh. 90.31 to the US dollar by end of November 2011. In December 2011, the rate was raised to 18 percent causing further strengthening of the Kenya shilling.

(iv) Through various regulatory interventions, circulars, moral suasion, among other approaches (see Section 4.1 on the Central Bank of Kenya).

6.3 While some of the measures such as the sale of foreign exchange and interventions to reduce Government spending were largely inadequate, some of these measures, due to their sheer magnitude ended up hurting the same Kenyans they were supposed to protect. Primarily, the shock increase in the CBR to 16.5 % and further to 18 percent lend to a sharp rise of lending interest rate in the Banks and contraction of credit to the private sector. Many commercial Banks have adjusted their base rates from an average of 15 percent to about 24 percent. For some Banks, actual lending rates are about 30 percent. Business people and consumers are finding these rates exorbitant, and without an alternative source of money, businesses either postpone investments.

6.4 Ultimately, high interest rates will cause a fall in economic growth, worsen the unemployment situation and increase poverty. The increase of CBR has also contributed to reduced subscription of Government securities since Banks find it more profitable and prudent to lend to each other through interbank lending or overnight lending than investing in T- bills and T-bonds,

## CHAPTER FOUR

### COMMITTEE FINDINGS AND RECOMMENDATIONS

#### 7.0 FINDINGS

7.1 The Committee's sittings were quite fruitful and helpful in isolating the primary drivers of the drastic depreciation of the Kenya shilling. The Committee received diverse submissions and explanations of the possible causes of the drastic decline of the shilling which it divided into economic, human and institutional failures. The economic causes such as the wide current account deficit, Euro crisis, large import bill of non-essential commodities, the Arab Spring, are still in place even after the shilling recovered its value since December 2011. The Committee therefore zeroed on institutional and human failures. These factors include policy indecisiveness and inaction of the CBK, speculative activities of some Banks and individuals, and inaction by the Ministry of Finance.

7.2 The Committee's findings on the cause of the sharp decline of the shilling are as follows;

7.2.1 **Policy indecisiveness and inaction of the Central Bank of Kenya (CBK)**  
- The Committee finds the following acts as directly linked to the slide of the shilling:

- (i) **Creating opportunities for arbitrage** - Failure by the CBK to detect and close in time the gap between the interest rate on Discount Window of the CBK, the rate on the interbank lending market and rates on Treasury bills and bonds. The Committee is convinced that commercial Banks exploited this loophole for monetary gains. The problem of the exchange rate could have been addressed to a great extent through a rise in the CBR as early as June 2011 and also the placement of stringent penalties on the abuse of the Discount Window.

- (ii) **Failure to detect and arrest speculative activities** - The Committee also found that the CBK failed to detect and arrest speculative activities of the financial market players through several financial instruments that fueled the sharp volatility and sudden fall of the shilling in 2011. This is related to weak monitoring and surveillance of financial markets.
- (iii) **Unclear Communication to financial markets** - The Committee felt that CBKs communication strategy was ineffective during part of the year, and this may have created conditions for further speculative activities or unresponsiveness of market players to CBK's policy signals. Indeed, the signals from the CBK to the market and failure to intervene were creating more confusion in the market sparking panic buying by importers and increased speculation backed by series of circulars issued by CBK.
- (iv) **Ineffectiveness of the Monetary Policy Committee (MPC)** -The buildup to the decline of the shilling was evident as early as January 2011, but the CBK through the MPC failed to discern the signals and stem the crisis before it reached its peak. The Committee observes there is ineffectiveness on the part of the MPC, especially its failure to meet regularly, its composition, and its inadequate response to the shilling's decline as one of the problem that worsened the situation last year.
- (v) **Inadequate policy responses** – The Committee finds that policy responses were either inadequate or came in too late. Slow reaction of by the Central Bank of Kenya to the problem made exchange rate problem spiral out of control. Tracking CBKs response to the exchange rate and inflationary pressures throughout the year provides a hint on what went wrong. The CBK firstly increased the CBR on March 23, 2011 from 5.75% to 6% which was revised again to 6.25% on 4<sup>th</sup> June, 2011. The CBR rate was not reviewed again until September 15<sup>th</sup> 2011 but

this was raised to only 7% despite the fact that the Kenya shilling was rapidly losing value and inflation was rising. The CBK kept the CBR fairly flat for about 9 months.

- (vi) Belated intervention by the CBK– CBKs response through hiking the CBR rate to 18% was too drastic and costly to the economy. This has forced the Banks to hike their lending rate to more than 30 percent for new and old loans. Kenyans are now at risk of becoming paupers due to high interest rate payments.

#### 7.2.2 Governor of the CBK - The Committee finds that the CBK Governor:

- (i) Did not react in good time to the problem of sharp decline of the shilling which triggered a panic and fertile ground for hoarding in foreign currencies and speculation. This was corroborated by several commercial Banks, the Taskforce, all the economic experts and other organizations.
- (ii) Kept CBK Discount Window interest rates below the interbank rate and Treasury bill rates that encouraged the commercial Banks to by-pass the interbank market to borrow from the Discount Window.
- (iii) Allowed communication breakdown between the CBK and the Banks.
- (iv) The Governor played down the gravity of the problem to the extent that in various instances he was quoted in the media saying that he would not intervene in the foreign exchange market.
- (v) Being less candid with information. For instance, the Governor claimed public in the media that some Banks, which he refused to name, were responsible for arbitrage and hoarding of foreign currencies. The Governor was therefore not candid enough and honest to the Kenyans and even to this Select Committee.
- (vi) Overseeing the rise of the CBR rate to 18%, hence occasioning Kenyans heavy interest rate payments.

(vii) The Committee is of the view that the Governor is squarely responsible for creating the opportunity for Banks and individuals to make quick money.

(viii) His announcement and release of CBK circular to bypass the Banking system and deal directly with buyers or sellers of foreign exchange, although reversed, was in complete disregard of the financial structures. This could have opened opportunities for rationing of foreign exchange, occasioned parallel markets to thrive and creation of multiple currency practices (see annex 5).

**7.2.3 Arbitrage by commercial Banks** - Various financial players, including commercial Banks participated in arbitrage. Although this is not illegal and is a common business practice, the Committee observed that Banks exploited loopholes in the financial market to borrow funds from the CBK through the Discount Window and used the funds to profit from foreign exchange trading or to buy Government securities. The Committee can infer that in fact Banks were using the Discount Window to lend in the interbank market the same day or the next day since the Banking Circular No. 5 of June 29, 2011, Banking Circular No. 6 of July 11, 2011, and Banking Circular No. 8 of August 12, 2011 sought to curtail this practice. The Committee also found that Kenya Bankers Association, in a meeting with CBK, had expressed concern about the small Discount Window rate relative to the interbank market rates which was opening up opportunities for arbitrage.

**7.2.4 Commercial Banks with increased foreign exchange trading activity** - Three Banks namely; CFC Stanbic Bank, Standard Chartered Bank, and Citibank were reported to have had increased foreign exchange trading activity. CBK wrote to them seeking explanation. (see annex 18).

**7.2.5 Suspension of specific financial institutions from participating in the interbank market or foreign exchange market** - the Governor reported that CFC Stanbic Bank had flouted the guidelines issued on October 13,

2011 regarding the tenor of foreign currency swaps. The Bank was suspended from participating in the swap market for 30 days and was also penalized Ksh. 1 million in line with the Banking Act (Section 2(a) of Legislation No. 77 of 1999: The Banking (Penalties) (Amendment) Regulations 1999).

**7.2.6 Commercial Bank Foreign Exchange holdings-** The Committee finds that 12 major Banks held 87.7% of total foreign assets by September 2011 (see annex 3).

**7.2.7 Conflict of Interest**—the Committee finds that top management and board members in some Banking institutions hold board positions in key public policy organs which are tasked with major development projects in the country. This is a source of disaffection among Banks which feel undue advantage is gained by such Bank executives. For instance, the CEO of Equity Bank chairs the Vision 2030 board which in the Committee's and other Banking institutions provides undue advantage on present and future information about inflow of funds towards infrastructure development. Similarly, the chairman of Equity Bank chairs the National Oil Corporation.

**7.2.8 Kenya Bankers Association** – The Committee found that Kenya Bankers Association (KBA) discussed the problem of monetary policy in a meeting with CBK. The Committee found that the interactions between the regulator and KBA, which is an interest group for profit seeking Banks, was inappropriate in free markets. This opens up opportunities for collusion, arbitrage and speculation in foreign currencies.

**7.2.9 Inaction by the Ministry of Finance** – The Ministry of Finance failed to exercise the provisions of the Central Bank Act (Cap 491 section 4c) and take a proactive role to tame the decline of the shilling. Under the law, Treasury can intervene (take over monetary policy) upon

approval by the Cabinet for a period of 6 months if the CBK shows inability or unwillingness to pursue the intended monetary policies.

**7.2.10 Working relationship between the CBK and commercial Banks-** the poor relationship between these financial players necessitated the formation of a taskforce in the office of the Prime Minister. However, this did little to arrest the direction of the Kenya shilling.

**7.2.11 Failure by the fiscal and the monetary policy organs of the Government-** to take timely corrective measures to arrest the slide of the shilling against major currencies. The Committee finds that the CBK was far too slow to react to the problem of the shilling which triggered a panic and fertile ground for hoarding in foreign currencies and speculation.

**7.2.12 Capital Flight** -The country suffered capital flight during the period when the Kenya shilling was depreciating. The uncertainties about the unpredictable exchange rate of the Kenya shilling fuelled negative expectations about the economy and key macroeconomic variables. The fall of the NSE 20 share index from 4464.9 points in January 2010 to 3120.88 in December 2011 was partly associated with the increased activity among foreign investors at the stock market. The capital market authority failed to share with the Committee the magnitude of capital flight from the NSE and major actors involved.

**7.2.13 Global economic crisis-** The Committee finds factors external to the domestic economy to have played a role in the decline of the shilling. These include Euro zone debt crisis, US debt crisis, and Political events in the Middle East and North Africa. However, since these conditions still persist, the Committee considers them not have been the main causes for the drastic depreciation of the shilling.

## 7.3 RECOMMENDATIONS

7.3.1 On the basis of the above findings, the Committee has drawn a range of recommendations which will ensure that future crisis such as the sharp depreciation of the shilling in 2011 is not replicated. The Committees' recommendations span both economic and institutional changes as follows:

### 7.3.2 Monetary Policy

(i) **Governor of the CBK** –Failures attributable to the CBK during the period of the decline of the shilling, and the Governors own conduct bordering on incompetence created panic and fertile ground for Banks and individuals to make quick money. The Committee finds the Governor's conduct and behavior incompatible with the holder of the office of Governor of the Central Bank of Kenya and therefore recommend:

- The Governor takes responsibility for allowing the sharp decline of the shilling.
- The Governor steps aside to pave way for thorough investigation.
- That the President should constitute a Tribunal to investigate the Governor's conduct, incapability, connivance and incompetence to perform the functions of the office as per the provisions of the CBK Act Cap 491 section 14 (2)(f) and 14(3).

(ii) **Productive communication between CBK and financial market players** - the Committee recommends that CBK should design a framework of engaging with foreign exchange market players within the confines of the financial market laws and regulations.

(iii) **Coherence of monetary policy** - The Committee found that the CBK may have been overenthusiastic about economic stimulus and also maintained the low interest rate regime for far too long.

The Committee therefore recommends that the CBK should maintain a coherent monetary policy at all times with a focus on price stability.

- (iv) **Early warning mechanism** - CBK should put in place thresholds or trigger values for which the foreign exchange should fluctuate in times of extreme crisis and at which the CBK would move in to restore stability.
- (v) **Strengthen Reserve Position of the CBK** - The Committee recommends that the Government should take adequate steps to boost the reserve position to at least the 4 months of import cover to strengthen its ability to respond to market volatility.
- (vi) **Enforcement of the In-Duplum Rule** – The In-Duplum rule as provided under section 44A of the Banking Act needs to be enforced. In addition, the Act needs to be amended to apply to all loans – both performing and non-performing.

### 7.3.3 Legal Amendments

Suggested amendments to the CBK Act can target, but are not restricted to the following:

- (i) **Position of Chair and deputy Chair of the CBK Board** - The Central Bank Act (CAP 491 section 11 (1)(a)(b)) should be amended to provide that the CBK Governor and the Deputy Governor cannot chair the Board of Directors which is expected to review his performance in achieving the CBK core mandates.
- (ii) **Appointment of the Governor and Deputy Governor** - The Committee recommends that the CBK Governor and Deputy Governor be recruited through a competitive process.

- (iii) **Oversight over CBK** - The Committee also recommends that the CBK Act should be amended to provide that the CBK Governor appears on a quarterly basis before a relevant parliamentary Committee of the National Assembly to expound on monetary policy and other actions related to the discharge of the CBK core mandate of price stability and financial stability.
- (iv) **Autonomy of the CBK**–Strengthen the autonomy of the two arms of CBK namely, the Bank supervision/financial markets on one hand and monetary policy arm on the other.
- (v) **Sanctions** - To provide for punitive sanctions on the Management of the Bank for gross failure in attainment of important monetary policy objectives or failure which occasions the country huge losses, the Committee recommends the introduction of amendment to the CBK Act.
- (vi) **The Monetary Policy Committee** – To include the input of supervisory arm of CBK in monetary policy decision making, the Committee proposes amendment of CBK Act to provide for an extra member to the MPC of a CBK staff responsible for Bank supervision. The performance of the MPC during the crisis and in particular the handling of the sharp depreciation of the shilling was found to be wanting. The Committee recommends a reconstitution of the current MPC to reflect the requisite expertise that will inform the monetary policy direction in the country.
- (vii) **Conflict of interest**– To provide for a fair and level playing field in the Banking sector and to avoid conflict of interest, the Committee recommends that senior managers and board members of Banks should not hold positions in Government policy organs or Government commissions with direct impact on financial and monetary policies.

#### 7.3.4 Supervisory Oversight of Financial Institutions

- (i) **Tools to efficiently monitor financial markets** - CBK needs to develop tools to properly and efficiently monitor the financial markets, particularly find tools to quickly deal with the adverse effects of innovations in foreign exchange trades such as the Electronic Brokerage System, foreign exchange swaps and carry trades.
- (ii) **Responsiveness to market developments** - The CBK should increase the speed and responsiveness to market developments to deal with rapidly changing financial market behavior.
- (iii) **Independent forensic audit** - Possible speculation and abnormal trading in foreign exchange could have been prevented if action was taken in a timely manner. The Committee also recommends
  - Ethics and Anti-Corruption Commission (EACC) and the Auditor General's office to carry out an independent forensic audit on the operations and transactions of the Discount Window and foreign exchange trading of twelve Banks which had the largest foreign exchange holdings by September 2011. (see annex 3).
  - The CMA to conduct a comprehensive investigation of the NSE to determine whether there were institutions that involved in suspect capital inflows and outflows from the bourse and report to parliament within 90 days from the date of adoption of this report by the House.
- (iv) **Review of internal processes** - The Committee recommends that the CBK carries out an internal audit of what went wrong in monetary operations and Bank supervision with a view to rectifying the problem.

- (v) **Banking penalties regulations** – The Committee recommends amendments be made to the CBK Act and the Banking Act in order to revise and enhance the penalties which may be imposed for breach of CBK regulations. Such penalties should be proportionate of the value to the Bank of the malpractice at that particular time. The Committee found the amount of penalty, Ksh. 1 million too lenient and therefore recommends a more deterrent penalty of 50% of the amount involved or Ksh. 20 million whichever is greater (regulation 2 of the Banking (penalties) Regulations, 1999).

#### 7.3.5 Fiscal Policy

- (i) **Reduction of the current account deficit through exports promotion.**
- (ii) **Placing tariffs and non-tariff barriers on non-essential imports** - To reduce the import bill, the Ministry of Finance should explore ways through the regional trading arrangements to increase tariffs on non-essential commodities.
- (iii) **Exercise of powers provided under the law** - The Committee recommends that the Ministry of Finance should not hesitate to take policy measures if the CBK grossly deviates from its monetary policy statement.
- (iv) **Strong macroeconomic fundamentals** - The Committee finds the CBK and the Treasury lacking in strong macroeconomic fundamentals in the form of policy. Both institutions appear to have been overenthusiastic about economic stimulus. The CBK also maintained the low interest rate regime for far too long. The Committee therefore recommends that the CBK should maintain a coherent monetary policy at all times with a focus on price stability.

- (v) **Coordination between the monetary and fiscal policy institutions**  
-The effectiveness of the monetary policy in a country must be matched with an equally effective fiscal policy, particularly so when dealing with a crisis of the magnitude the decline in value of the shilling. Fiscal spending remained high before some austerity measures were issued. The Committee recommends effective policy coordination between the fiscal and monetary authorities/agencies.

7.3.6 Finally, the current interest rates of slightly over 30% charged by banks are unrealistic, harmful and untenable. Therefore, the Government, CBK and financial market players should put in place deliberate mechanisms to reduce the interest rate to affordable rates within three (3) months of adoption of this report by the House.

**Table 1: Foreign Exchange Holdings by Select Commercial Banks by  
September 2011**

Bank	Total Holdings (Ksh '000)	Bank Holdings as Percent of Total Industry Holdings	Cumulative Percentage
CfC Stanbic Bank (K) Ltd	70,425,709	17.0%	17.0%
Kenya Commercial Bank Ltd	57,476,699	13.9%	30.9%
Standard Chartered Bank (K) Ltd	46,561,144	11.3%	42.2%
Citibank N. A. Kenya	29,179,720	7.1%	49.2%
Barclays Bank of Kenya Ltd	26,562,409	6.4%	55.6%
Commercial Bank of Kenya Ltd	26,086,714	6.3%	61.9%
I&M Bank Ltd	23,252,309	5.6%	67.6%
Diamond Trust (K) Bank Ltd	22,094,803	5.3%	72.9%
NIC Bank Ltd	20,295,571	4.9%	77.8%
Equity Bank Ltd	15,372,270	3.7%	81.5%
Co-Operative Bank of Kenya Ltd	13,355,225	3.2%	84.8%
Bank of Africa (K) Ltd	12,081,122	2.9%	87.7%

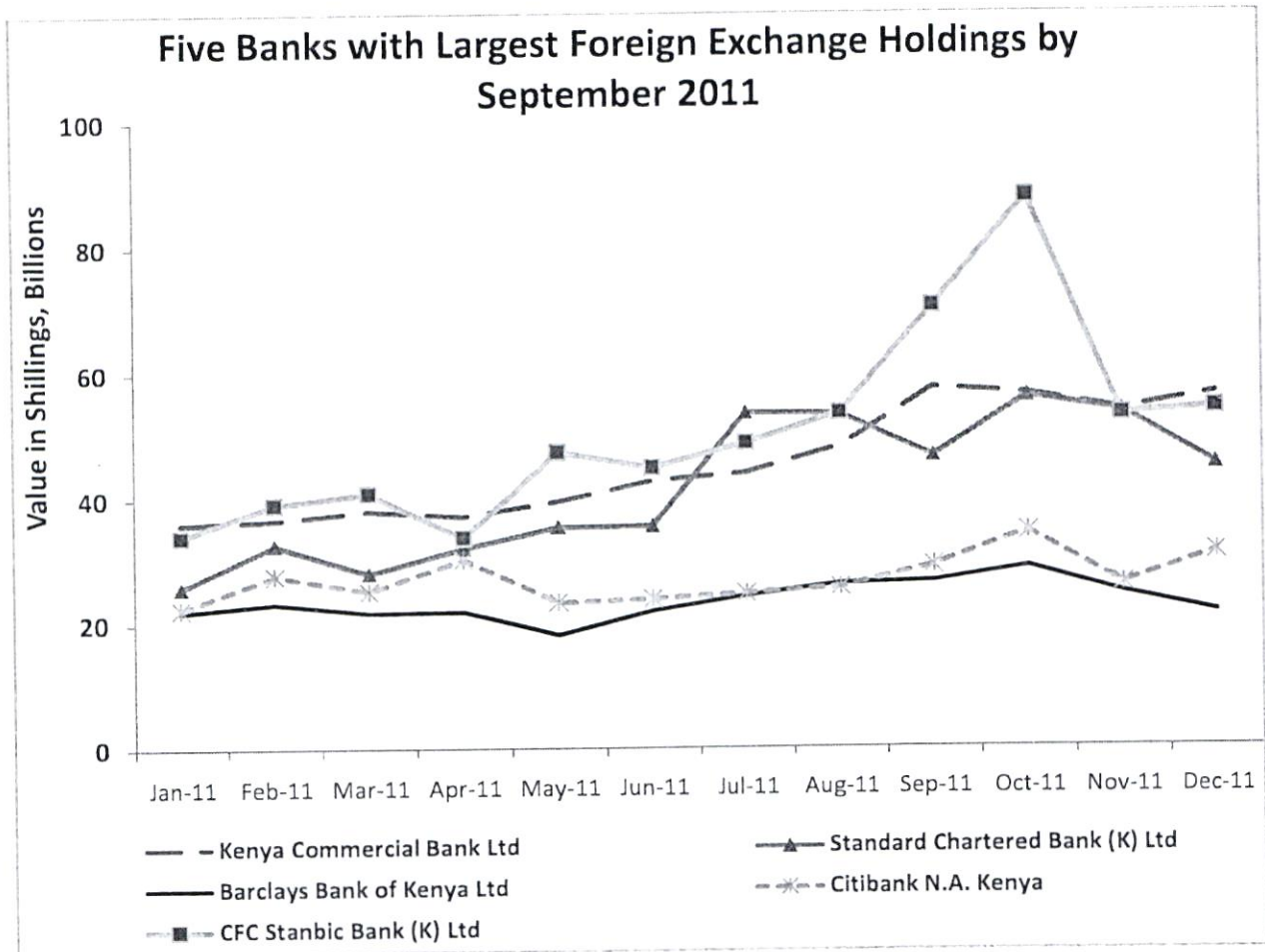
Source: Central Bank of Kenya

**Table 2: Commercial Banks Borrowing from CBK and Profits, 2010-2011**

Banks	Central Bank Window Borrowing (Ksh. Billions)		Profit before tax (Ksh. Billions)	
	2010	2011	2010	2011
Kenya Commercial Bank Ltd	0.960	148.420	6.500	9.100
Standard Chartered Bank (K) Ltd	1.170	7.555	6.185	5.492
Barclays Bank of Kenya Ltd	2.329	146.555	7.015	8.867
Commercial Bank of Africa Ltd	0	3.150	--	--
Cooperative Bank of Kenya Ltd	2.296	186.481	4.302	5.544
Citibank N.A Kenya	0.700	0	--	--
Bank of Africa (K) Ltd	1.280	23.768	--	--
CfC Stanbic Bank (K) Ltd	0.701	1.920	1.506	2.378
NIC Bank Ltd	0	3.980	2.004	2.577
I&M Bank Ltd	0.012	22.744	--	--
Diamond Trust Bank (K) Ltd	0	2.280	2.351	3.110
Equity Bank Ltd	1.664	53.336	6.464	8.246

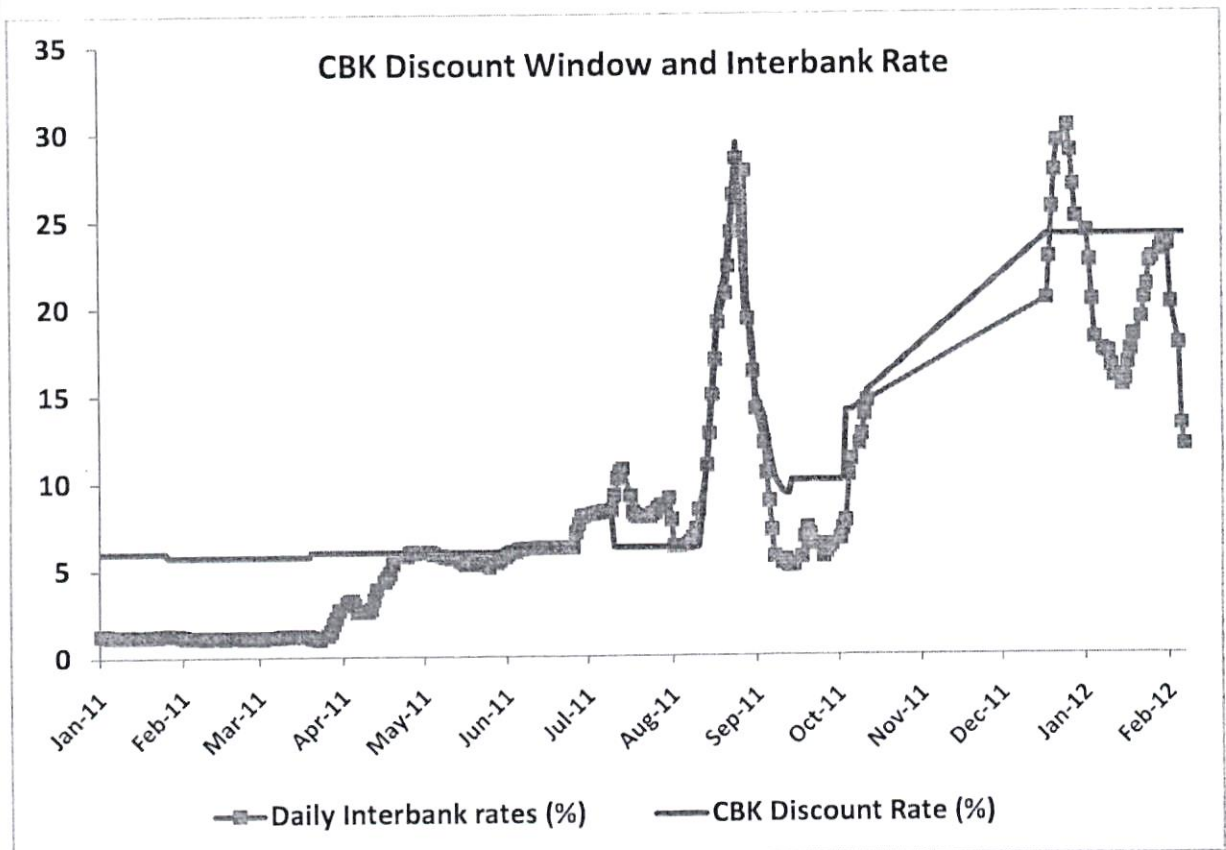
Source: CBK data, Financial Statements of listed banks

Figure 1



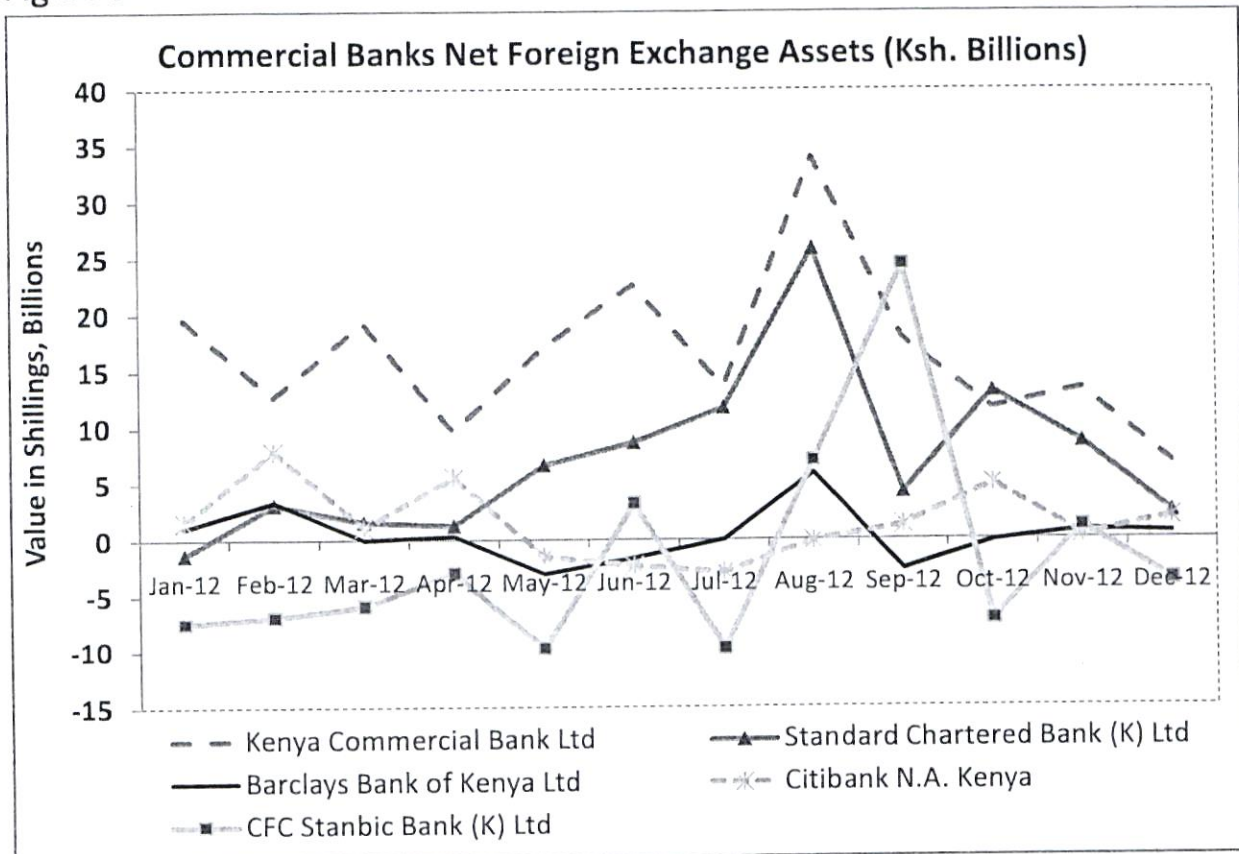
Source of data: Central Bank of Kenya

Figure 2



Source of data: Central Bank of Kenya

Figure 3



Source of data: Central Bank of Kenya

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## PROPOSED AMENDMENTS

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Insertion of  
new section  
12A in Cap.  
485A.

1. The Capital Markets Act is amended by inserting the following new section immediately after section 12—

Report to  
committee  
of  
National  
Assembly.

12A. The Authority shall, on a quarterly basis, appear before the relevant committee of the National Assembly to expound on its mandate under this Act.

Deletion of  
section 44A  
of Cap.  
488.

2. The Banking Act is amended by deleting section 44A and substituting therefor the following new section—

Limit on  
interest  
recovered  
on loans.

44A. (1) An institution shall be limited in what it may recover from a debtor with respect to a loan to the maximum amount under subsection (2).

(2) The maximum amount referred to in subsection (1) is the sum of the following—

(a) the principal owing;

(b) interest, in accordance with the contract between the debtor

and the institution, not exceeding the principal owing; and

(c) expenses incurred in the recovery of any amounts owed by the debtor.

(3) This section shall not apply to limit any interest under a court order accruing after the order is made.

(4) In this section—

(a) “debtor” includes a person who becomes indebted to an institution because of a guarantee made with respect to the repayment of an amount owed by another person; and

(b) “loan” includes any advance, credit facility, financial guarantee or any other liability incurred on behalf of any person.

(5) This section shall apply with respect to loans made before this section comes into operation.

Insertion of

3. The Banking Act is amended by

new section  
49A in Cap.  
488.

inserting the following new section immediately  
after section 49—

Penalty for  
non-  
compliance  
with  
Central  
Bank  
directions.

49A. Any institution or other  
person who fails or refuses to  
comply with any directions  
given by the Central Bank  
under the Act shall be liable to  
a penalty of twenty million  
shillings or, if the directions  
relate to monetary transactions,  
a penalty equivalent to fifty per  
cent of the amount of money  
transacted.

Amendment  
of section  
4D of Cap.  
491.

4. Section 4D of the Central Bank of  
Kenya Act is amended—

- (a) in subsection (2), by deleting the word “two”  
appearing in paragraph (c) and substituting  
therefor the word “three”;
- (b) in subsection (2A), by—
  - (i) deleting the word “two” and substituting therefor  
the word “three”;
  - (ii) inserting the following new paragraph  
immediately after paragraph (b)—  
“(c) one shall be a person with executive  
responsibility within the Bank for supervision of  
banks.”;
- (c) in subsection (6), by deleting the word “six”  
appearing immediately before the word “months”  
and substituting therefor the word “three”.

Amendment  
of section 11  
of Cap. 491.

5. Section 11 of the Central Bank of Kenya Act is amended—

- (a) in subsection (1), by deleting the words “who shall be the chairman” appearing in paragraph (a);
- (b) by inserting the following new subsection immediately after section (1)—

“(1A) The chairman of the Board, who shall be a person who is qualified in economics or finance, shall be appointed by the President.”
- (c) in subsection (2), by inserting the words “through a competitive process” immediately after the word “President”.

Insertion of  
new section  
4E in Cap.  
491.

6. The Central Bank of Kenya Act is amended by inserting the following new section immediately after section 4D—

Report to  
committee  
of  
National  
Assembly.

4E. The Governor shall, on a quarterly basis, appear before the relevant committee of the National Assembly to expound on the monetary policy formulated by the Bank, and to report on other actions related to the mandate of the Bank.

MINUTES OF THE 1<sup>ST</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON FRIDAY, 18<sup>TH</sup> NOVEMBER, 2011 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Benjamin Langat, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Peter Kiilu, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. George Otieno

NATIONAL ASSEMBLY

- Clerk Assistant

MIN. NO.01/2011:

PRELIMINARY

The meeting started with a word of prayer. The Clerk Assistant informed the Members that the meeting had been convened pursuant to Standing Order No.163 which states that:-

*"The Clerk shall arrange a time for the first meeting of a Committee within seven days of its constitution and as soon as the quorum is present, the Clerk shall conduct the election of the Chairperson and vice Chairperson."*

MIN. NO.02/2011:

ADOPTION OF AGENDA

The Agenda of the sitting was adopted by the Members present as follows:-

- (i) Election of the Chairperson
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

MIN. NO.03/2011:

ELECTION OF THE CHAIRPERSON AND VICE  
CHAIRPERSON

The Clerk called for nominations for candidates for the position of Chairperson; The Hon. Adan Keynan, MP was proposed for the position of Chairperson by the Hon. (Prof) Philip Kaloki, MP and was seconded by the Hon. Benjamin Langat, MP.

There being no other proposal, the Clerk declared The Hon. Adan Keynan, MP as the duly elected Chairperson of the Committee.

The Clerk congratulated the Chairman on his election and then handed over to the Chairman to assume the Chairmanship.

Subsequently, the Chairperson called for nominations of candidates for the position of Vice Chairperson; The Hon. Rachel Shebesh, MP was proposed by The Hon. Adan Duale, MP and seconded by The Hon. Abdul Bahari, MP. There being no other proposal for the Vice Chairperson's position, the Chairman declared The Hon. Rachel Shebesh, MP as the duly elected Vice Chairperson of the Committee.

MIN. NO.04/2011:

REMARKS BY THE CHAIRMAN AND VICE  
CHAIRPERSON

The Chairman thanked the Members for the confidence they had bestowed in him by electing him the Chairman. He further underscored the importance of the Committee and the immense work ahead arising from the tight schedule and urged the members to be prepared for the task ahead.

The Vice-chairperson also thanked the Committee Members for the confidence they had shown in her and confirmed that she is up to the challenge.

MIN. NO.05/2011 :

ANY OTHER BUSINESS

After lengthy deliberations, the Committee resolved as hereunder:-

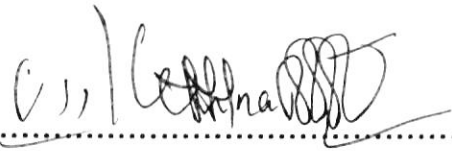
- (i) That the Committee gets a brief from the Parliamentary Budget office on the issues to be addressed.
- (ii) That a draft programme be presented to the Committee during its next sitting.

(iii) That the following organizations appear before the Committee:-

- Central Bank of Kenya
- Deputy Prime Minister and Minister For Finance
- Kenya Private Sector Alliance
- Kenya Bankers Association
- Forex Dealers Association of Kenya
- Kenya Consumer Watch
- Standard Chartered Bank
- Stanbic Bank
- Equity Bank
- Kenya Commercial Bank
- Commercial Bank of Africa
- Citi Bank
- Institute of Economic Affairs
- Kenya Institute of Public Policy Analysis
- University of Nairobi, School of Economics
- Former Central Bank Governor
- Kenya Revenue Authority
- Kenya Ports Authority
- Kenya National Bureau of Statistics
- Strathmore School of Business
- Kenya Importers Association
- Kenya Manufacturers Association
- Kenya Export Promotion Council
- Kenya Investment Authority
- Car Dealers Association of Kenya
- Kenya Real Estate Association
- Kenya Petroleum Association
- Energy Regulatory Commission
- Kenya Tourism Board
- Nairobi Stock Exchange
- Association of Foreign Currency Dealers
- National Security Intelligence Service
- Economic Affairs Group

MIN. NO.06/2011 : ADJOURNMENT AND DATE OF NEXT MEETING

There being no other business and the time being Thirty Six Minutes past Twelve O'clock, the meeting was adjourned until Thursday 24<sup>th</sup> November, 2011 at 10.00am.

SIGNED.....  
(CHAIRMAN)

DATE..... 07/02/12

MINUTES OF THE 2<sup>ND</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON THURSDAY, 24<sup>TH</sup> NOVEMBER, 2011 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Benjamin Langat, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Peter Kiilu, M.P.

ABSENT WITH APOLOGY

The Hon. Moses Lesonet, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

NATIONAL ASSEMBLY

Ms. Phylis Makau - Head Budget Office  
Mr. George Otieno - Clerk Assistant  
Mr. James Ginono - Clerk Assistant  
Mr. Martin Masinde - Fiscal Analyst  
Mr. Robert Nyaga - Fiscal Analyst  
Mr. Gilbert Kipkirui - Fiscal Analyst  
Mr. Gichohi Mwaniki - Fiscal Analyst  
Ms. Farida Ngasura - Hansard Recorder  
Mr. Simon Muinde - Hansard Recorder

MIN.NO.07/2011

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairperson informed Members that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO.08/2011:

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:-

- (i) Submission by the Parliamentary Budget Office
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

MIN. NO.09/2011:

SUBMISSION BY THE PARLIAMENTARY BUDGET OFFICE

The Parliamentary Budget Office informed the Committee that:-

- (i) the Kenya Shilling has substantially weakened relative to major international currencies since the start of the year 2011. It lost 32% from Kshs. 80.80 to the US dollar on January 3<sup>rd</sup> 2011 to a lowest ever mean rate of Kshs. 107 to the dollar on October 12<sup>th</sup>, 2011. However, the Shilling has appreciated against the dollar over the past few weeks;
- (ii) the Kenya Shilling exchange rate depreciation particularly contributed to a rise in the price index of energy products such as petroleum and electricity drawn from petroleum oils;
- (iii) the overall inflation has been on the upward trend rising from 5.24% in January to 18.91% in October. Since Kenya is a net importer, the Shilling depreciation and the associated inflation are bound to hurt the economy; and
- (iv) the Central Bank of Kenya reacted to this by tightening the monetary policy which is expected to increase the cost of borrowing thereby reducing the supply of money on the economy, demand for goods and services and curbing inflation. These policies appear to have some effect since the Shilling has appreciated.

**Possible Causes of Weakening of the Shilling**

- (i) **Current Account Deficit:** The widening gap between imports and exports of merchandise goods means that the country needs more foreign exchange for imports than it receives from exports, hence exerting pressure on the Shilling. Higher inflation further worsens the situation since it raises the cost of export products relative to countries with lower inflation. Thus, even though a depreciated Shilling is good for our exports, higher inflation tends to reduce our export competitiveness which may further worsen the current account. Besides, the Euro zone and the Middle East and North Africa countries are some of the major trading partners of Kenya. Given the current financial crisis in the European Community and political instability in the Middle East and North Africa region, exports to these regions declined worsening the current account balance.
- (ii) **The Euro Debt Crisis:** Most currencies have weakened against the dollar in the recent past. The financial market risks associated with debt crisis in several Euro countries has caused many investors to switch from the Euro to the Dollar which is regarded as a more stable currency.
- (iii) **Supply Shocks:** Since 2009, Kenya has been grappling with a persistent drought. This coupled with poor agricultural yields the previous year has contributed to the dwindling food reserves in the country. This has led to the importation of basic food stuffs such as maize leading to the huge import bill compared to export earnings. This exerted pressure on the Shilling as it increased the demand for dollars to facilitate payment of imports without a corresponding increase in exports.
- (iv) **Uncertainty in the Economy:** Risk averse investors spurred by the political uncertainty in Kenya have been progressively divesting from the economy in favour of safer haven for their funds. This includes selling their securities to buy dollars or evading risk by investing into the bonds market which are more secure. This is evident through the decline in the performance of the Nairobi Stock Exchange.
- (v) **Speculation:** Speculators may have read the market and taken the position that the Shilling will weaken further thus raising demand for more dollars in order to make a profit. Central Bank of Kenya blamed some banks for hoarding of dollars for speculation.
- (vi) **Disruption in inflow of funds from neighboring Countries:** There has been a steady and unregulated inflow of foreign currency from the neighboring countries and this has served to artificially prop up the local currency by increasing its demand. With the recent remedial actions on piracy and policing of the country's borders, the inflow of foreign exchange has decreased downward thereby putting pressure on the Shilling.
- (vii) **Non-responsive monetary policy stance:** The Budget Committee had observed in a report on the Budget Policy Statement and advised the relevant authorities to strike a balance between exports and imports and that Central Bank of Kenya should intervene if exchange rates fall below Kshs.84 to the dollar. This was ignored. Besides, as early as May 2011, there was a ministerial statement on the floor of the House which indicated that all was not well in the currency market.

## Policy Options taken in the recent Past

- (i) **Successive increments in the Central Bank Rate (CBR) rate and the Cash reserve ratio to reduce money supply.**

This policy measure did the following:-

- a) reduced subscription of government securities since banks find it more profitable and prudent to lend to each other through interbank lending or overnight lending than investing in T- bills and T-bonds,
- b) Caused banks to adjust their base lending rates upwards to between 20 and 25%, the consequence of which are as follows:-
- borrowing became expensive which led to lower investments, reduced growth and rise in unemployment;
  - loan defaulters increased as it became more expensive to service variable rate loans and stay afloat for most businesses and households; and
  - fueling cost related inflation when companies increase their price margins to compensate for costly bank financing or capital.
- (ii) **Lowering the Foreign Exchange Exposure Limit of Commercial Banks from 20% to 10%:** This measure served to make foreign currency more readily available and therefore cheaper (in relation to Kenya Shilling) by forcing banks to hold less foreign currency assets, which also reduces foreign currency dealings and speculation.
- (iii) **Receipt of Extended Credit Facility (ECF) from International Monetary Fund (IMF):** Kenya secured an additional \$250 million under the ECF arrangement of the IMF to shore up the local currency and ensure that the country's balance of payments remained stable. It is important to note that since the weaker Shilling makes imports more expensive, it reflects negatively on the country's balance of payments since Kenya's economy is import dependent.

## Medium to long Term Policy Options to Ensure Stability of the Exchange Rate

- (i) **Strengthened reserve position of the Central Bank Kenya.** The reserve position of CBK stood at 3.41 months of import cover in the week ending 18<sup>th</sup> November 2011. However, it is worth noting that the statutory level is 4 months of import cover. To this end, the ECF from the IMF will assist in assuring supply of foreign currency and thus help restore certainty in the market and reduce speculation.
- (ii) **Futures Market.** One sector that is strained by the high fuel prices is transport. The prevailing fuel prices are passed directly to the consumers. One available option for players in this field is to explore options such as signing a long term oil supply

contracts. The Government could back such contracts for strategic reasons through guarantees, for example. This would make supply and price of oil in the market predictable to avoid hoarding of oil commodities.

- (iii) **Import substitution.** Measures to increase output of foodstuffs as well as encouraging local production of some of the imported products in order to reduce over reliance on imported products and discourage importation of non-essential goods through non-tariff barriers.
- (iv) **Maintaining the Policy of Market Determined Exchange Rate and Intervene to Reduce Short Term Volatility.** The Central Bank of Kenya (CBK) should allow the exchange rate to settle at a level that permits modest import of essential goods and services, promotes export led growth and ensures that the goods produced locally are attractive to our major trading partners. This can only be done by achieving stable inflation, reasonable interest rates and growth. It should be noted that artificial propping up of the currency at the expense of growth could further destabilize the economy. Thus measures to address the exchange rate depreciation through constraining lending and through high interest rates should be done cautiously. One of the best ways of addressing the exchange rate is through supporting industries that can reduce our import dependence and also promoting exports.
- (v) **Moral Suasion.** CBK should come up with a framework of engaging with all forex market players. This could reduce the need to drastically change key policy instruments like the CBR and the CRR.

**Committee Observations**

- (i) The Committee observed that while fundamentals then prevailing in the market accounted for the weakening of the Kenya Shilling, the speed and extent of depreciation was a pointer that the fundamentals alone could not be the driving force of the decline of the Kenya Shilling. It was noted with concern that the decline of the Kenya Shilling against other foreign currencies had become a trend during general election years in Kenya.
- (ii) The Committee further noted that the fundamentals as argued by the parliamentary Budget Office has not changed yet the performance of the Kenya Shilling was significantly improving by the day.

MIN. NO.10/2011

ADJOURNMENT

There being no other business and the time being thirty Minutes past Eleven O'clock, the meeting was adjourned.

SIGNED.....  
(CHAIRMAN)

DATE. 07/02/12.....

MINUTES OF THE 3<sup>RD</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON FRIDAY, 25<sup>TH</sup> NOVEMBER, 2011 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Benjamin Langat, M.P.  
The Hon. Peter Kiilu, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Adan Bare Duale, M.P.

ABSENT WITH APOLOGY

The Hon. Moses Lesonet, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. George Otieno  
Mr. Robert Nyaga  
Mr. Gilbert Kipkirui  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Prof. Njuguna Ndungu  
Dr. Heron Sirima  
Prof. Terry Ryan  
Prof. Francis Mweya  
Mr. Farida Abdul

CENTRAL BANK OF KENYA

- Governor Central Bank of Kenya  
- Deputy Governor Central Bank of Kenya  
- MPC, Member  
- MPC, Member  
- MPC, Member

Mr. Charles Koori - MPC, Member  
Mr. John Birech - MPC, Member  
Dr. Isaaya Maana - MPC, Member

**MIN. NO.11/2011:** **PRELIMINARY**

The meeting started with a word of prayer. After introduction, the Chairman informed the Central bank team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

**MIN. NO.12/2011:** **ADOPTION OF AGENDA**

The Agenda of the Sitting was adopted by the Members present as follows:-

- (i) Meeting with Central Bank of Kenya Governor
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

**MIN. NO.13/2011:** **SUBMISSION BY THE CENTRAL BANK OF KENYA GOVERNOR**

The Governor made his submission as follows:-

**Introduction to inflation and exchange rate pressures**

- (i) Inflationary pressures; food and fuel explains 68% of the overall inflation. Hence, adverse inflation differentials with our trading partners put pressure on the exchange rate to weaken the Shilling.
- (ii) Fuel prices in the international market were persistently high hence the pass-through effects to domestic markets were significant.
- (iii) Fuel import bill rose from 19.2 % of the total cost of imports in January 2011 to peak at 31% in August, putting pressure on the current account and available foreign exchange.
- (iv) Current account deficit, at almost 12% of the GDP, was beyond the 5-8% range expected for developing countries.

- (v) The Euro- zone and US debt crises caused instability in currencies worldwide with the US Dollar strengthening as the preferred reserve currency.

#### Factors causing inflation and exchange rate pressures:-

- (i) Fuel price shock typical effects- hit domestic prices upwards and domestic output downwards.
- (ii) Current account deficit widened putting pressure on the exchange rate to weaken. Major imports such as fuel, food, machinery and equipment.
- (iii) Imports were rising faster than exports, hence a huge deficit every month.
- (iv) The import bill for fuel increased putting pressure on the trade balance and hence on the exchange rate.
- (v) Euro-zone crises increased the velocity of foreign exchange trading exerting pressure on demand for US dollars.
- (vi) Persistent drought effects in Kenya coupled with other shortages like sugar and power supply exacerbated the inflation situation.
- (vii) Private sector credit was rising faster than economic activity, threatening demand pressure on inflation.

#### Policy responses

- (i) Tighter monetary policy; 5<sup>th</sup> October 2011, raising Central Bank Rates (CBR) to 11%. On 1<sup>st</sup> November 2011, raising CBR to 16.5% and cash reserve ratio to 5.25% from 4.75% effective from 15<sup>th</sup> December 2011.
- (ii) Introduction of CBK guidelines on foreign exchange trading to control trading in foreign exchange derivatives.
- (iii) Sales of foreign exchange reserves by the CBK were complemented by other measures in stabilizing the exchange rate but these were limited by the amount of foreign exchange reserves.
- (iv) On the fiscal side, the government was committed to review its budgeted expenditures to cut down on non-priority area to support the tight monetary policy pursued by CBK.

#### Policy path to maintain direction

- (i) Prioritize of the monetary policy to bring inflation and inflationary expectations under control and protect the economic growth base; tight monetary policy to be sustained until inflationary pressures have been reversed
- (ii) Buildup of foreign exchange reserves to a stronger position to provide adequate buffers. CBK interventions in the inter-bank foreign exchange trading market could only dampen volatility.
- (iii) Regular interactions with market players to be sustained to enhance the effectiveness of the transmission mechanism of monetary policy and policy actions.

- (iv) The CBK will continue to monitor both domestic and global developments and will continue to take necessary measures to achieve and maintain price stability.
- (v) Continued regional coordination in policy actions and responses among the central banks within the East African Community.

### Committee Observations

- (i) The Committee was convinced that some of the reasons for the fall of the Shilling last year given by the CBK such as Euro- zone crisis, US debt crisis, North Africa political turmoil, and world oil prices among others had remained the same even after November 2011, but the Shilling had continued to strengthen. The Committee was of the opinion that the depreciation could not have been violent if some factors were addressed. The Committee isolated three factors as the primary drivers of the sudden fall of the Shilling particularly between May 2011 and October 2011 namely:-
  - the abuse of the Discount Window and related trades in foreign exchange;
  - overuse of various foreign exchange trade tools such as Electronic Brokerage System, currency swaps, and carry trades; and
  - the delay in CBK to detect the problem and respond adequately in a timely manner.
- (ii) In early 2011, the CBK noticed that there was high liquidity in the market and acted by mopping up the excess liquidity market Repurchase Agreement (REPO). This action evidently did not stop the drop of the Shilling. The market analysts had already noticed an issue in the financial market and they strategized themselves to make the best out of it. The financial market was tight on liquidity and it was evident the regulator would intervene. The CBK then returned to the market and injected back money through REPO in August 2011 to improve liquidity. This caused the Shilling to slide further since the now enlightened analysts used the credit to speculate on the Shilling. The CBK also participated in the foreign exchange market when the Shilling was weakening by selling off its foreign exchange reserves to strengthen the Shilling. This did little to save the Shilling since the country's foreign reserves were already below the 4 month import cover that is needed. With increased demand of the dollar, the new dollars from the CBK injection could have found their way to the speculators.
- (iii) CBK created a loophole in the market for local banks to arbitrage. In August 2011, cash-rich banks used the CBK overnight lending window, through which CBK acts as a lender of last resort, to finance lending to government and other banks by taking advantage of the Central Bank Rate (CBR) which was below the Treasury bill and the interbank rates. During that week, the interbank rate averaged 8.24 percent while CBR stood at 6.25 percent.
- (iv) The pronouncement by the CBK that it was not going to intervene to save the Shilling from depreciation and would let the market forces to stabilize was a major

- cause of the depreciation. This encouraged speculators to hold onto their foreign exchange with the hope for a continued depreciation.
- (v) The CBK responded to the problem of arbitrage among banks by increasing restrictions on the use of the discount window. It is believed that banks were using the discount window to access funds to invest in the government securities instead of using their dollar holdings. This therefore reduced dollars available in the foreign exchange markets. Indeed, the CBK Governor was allegedly quoted by the media saying that some banks were hoarding dollars offshore but borrowing heavily from the CBK. Banks took advantage of this due to the mismatch between the rates at the CBK discount window and the rates paid in government securities. It is unlikely that if CBK had not left this mismatch open, that banks would have used it profitably.
  - (vi) That the belated interventions by the CBK were very costly in several fronts: one, the depreciation fueled inflation which greatly reduced savings and living standards of low income earners; high interest rate affected investments, consumption, and economic growth, various institutions therefore reduced economic growth rate in 2011 from about 5.3 percent to less than 4 percent; high interest rates could have caused a rise in non-performing loans in the banking sector as borrowers found it harder to service variable rate loans; and, also reduce bank profitability and probably affect access to financial services. High interest rates fueled cost related inflation when companies increased their price margins to compensate for costly bank financing or capital.
  - (vii) There was no proper communication between CBK and Treasury on one hand and CBK and the Commercial banks on the other.
  - (viii) That, when asked to comment on media reports attributed to him that some banks were engaging in malpractices and that those banks might be responsible for the decline of the Kenya Shilling, he denied having made any such statements citing that the media had misquoted him.

### Committee Recommendations

- (i) CBK should urgently develop or strengthen capacity to monitor the financial markets so as to redress any sharp deviations from the normal market trading. The CBK needs to increase the speed and responsiveness to market developments and also to strengthen response to control rapidly changing market behavior in a way without curbing the normal operations of the markets. In addition, the CBK should put in place a reasonable threshold or trigger point at which the CBK could take action if the Shilling depreciates or appreciates by a certain margin.
- (ii) Penalties for non-adherence to prudential and other supervisory regulations and guidelines should be enhanced including custodial sentences for offending officers in the banks and stiffer monetary penalties among others.
- (iii) That, as noted in the observations above, the abuse of the Discount Window could have been prevented if action was taken in a timely manner. In order to uncover any wrong doing relating to the use of the Discount Window during

the period March 2011 to October 2011, the Committee recommend a forensic audit of banks' books during the period when they abused the Discount Window. This should be instituted to find out whether the banks breached any regulations at the time and if the required penalties were applied.

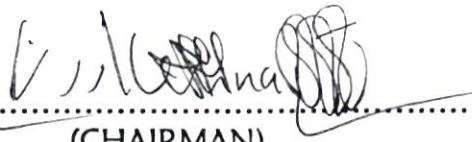
- (iv) That, though not directly apparent, some of the problems associated with the fall of the Shilling and the lethargic response by the CBK could be related to the operations of the CBK. The Committee therefore recommends a review of the structure and operations of the CBK with a view to making the institution more efficient and responsive to monetary crisis.

MIN. NO.14/2011:

ADJOURNMENT

There being no other business and the time being Twelve O'clock, the meeting was adjourned.

SIGNED.....



(CHAIRMAN)

DATE.....

07/02/12

MINUTES OF THE 4<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON MONDAY, 28<sup>TH</sup> NOVEMBER, 2011 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 10.00 A.M.

PRESENT

The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Benjamin Langat, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Adan Bare Duale, M.P.

ABSENT WITH APOLOGY

The Hon. Adan Keynan, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P  
The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Peter Kiilu, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. George Otieno  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Fiscal Analysts  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Ms. Stella Kilonzo  
Ms. Paul Muthaura  
Mr. Sammy Malanga

CAPITAL MARKETS AUTHORITY

- Chief Executive Officer  
- Director regulatory policy and strategy  
- Manager, research, marketing infrastructure and product development

MIN. NO.15/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Vice Chairperson informed the Capital Markets Authority team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This she said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

**MIN. NO.16/2011:**

**ADOPTION OF AGENDA**

The Agenda of the Sitting was adopted by the Members present as follows;

- (i) Meeting with Capital Markets Authority
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

**MIN. NO.17/2011:**

**SUBMISSION BY THE CAPITAL MARKETS  
AUTHORITY**

The Capital markets Authority informed the Committee the following:-

- (i) The Capital Markets Authority was set up in 1989 as a statutory agency for facilitating the development of an orderly, fair and efficient Capital Markets in Kenya with the view to promoting market integrity and investor confidence.
- (ii) The regulatory functions of the Authority include: licensing and supervising all the capital market intermediaries; ensuring compliance with the legal and regulatory framework by all markets participants; regulating public offers of securities such as equities and bonds and derivatives and the issuance of other capital market development through research on new products and services; reviewing the legal framework to respond to market dynamics; promoting investor education and public awareness and protecting investors' interests.
- (iii) Factors such as interest rates and inflation, the exchange rate are key determinants of a country's relative level of economic health.
- (iv) The exchange rate of the currency in which capital markets asset portfolios are held impacts that asset portfolio's real return. A declining exchange rate may have decreased the purchasing power of any income and capital gains derived from any returns. If the underlying company invested and relied heavily on imported goods, the declining exchange rate resulted in an increase in costs thereby reducing

- potential profits and likelihood of the distribution of any income or capital gains on its securities.
- (v) From October 2010 to October 2011 the total equity fund flows showed a net inflow of Ksh5.1 billion.
  - (vi) There were no cases of insider dealing that the Authority was investigating or aware of in relation to the depreciation of the Kenya Shilling.
  - (vii) The depreciation of the Kenya Shilling had the following effects on the capital markets:
    - Earnings of companies fell, pulling with them investor share demand; there were more share sell-offs (therefore higher share supply than demand) leading to share price depression.
    - The cycle repeated itself in subsequent Shilling depreciation further stoking a bear run and as a result companies shied away from conducting IPOs fearing under subscription.

#### Committee Observations

- (i) The Committee observed that the government was not taking keen interest in the trading of the Nairobi Stock Exchange.

The Committee directed Capital Markets Authority to avail the following:-

- (i) Report on the volumes of trade.
- (ii) Communication with Treasury and Central Bank.
- (iii) Report on how the depreciation of the Shilling affected the market.
- (iv) Report on the way interest rates moved in year 2011.

MIN. NO.18/2011:

ADJOURNMENT

There being no other business and the time being Twenty Minutes past Eleven O'clock, the meeting was adjourned.

SIGNED.....

  
(CHAIRMAN)

DATE.....

07/02/12

MINUTES OF THE 5<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON THURSDAY, 1<sup>ST</sup> DECEMBER, 2011 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 10.00 A.M.

PRESENT

The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Benjamin Langat, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.

ABSENT WITH APOLOGY

The Hon. Adan Keynan, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Peter Kiilu, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. George Otieno  
Mr. Robert Nyaga  
Mr. Gilbert Kipkirui  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Dr. Thomas Nzioki Kibua

EXPERT

- Consultant African Development and Economic Consultancy Ltd

IN ATTENDANCE  
NAIROBI

SCHOOL OF ECONOMICS UNIVERSITY OF

Dr. Maurice Awiti  
Dr Benedict Ongeru

- Deputy Director School of Economics  
- Lecturer School of Economics

IN ATTENDANCE

INSTITUTE OF ECONOMIC AFFAIRS

Mr. David Owino

- Programme Officer

IN ATTENDANCE

KENYA INSTITUTE FOR PUBLIC POLICY  
RESEARCH ANALYSIS

Dr. Moses Ikiara  
Dr. Dickson Kainga  
Dr. Jacob Odour

- Executive Director  
- Head Microeconomics Division and Senior Analyst  
- Senior Analyst, Macroeconomics Division

MIN. NO.19/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Vice Chairperson informed the experts that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This she said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO.20/2011:

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows;

(i) Meeting with:-

- DR. Thomas Nzioki Kibua
- School of Economics, Nairobi University
- Institute of economic Affairs
- Kenya Institute for Public Policy Research and Analysis

(ii) Any Other Business

(iii) Adjournment and date of the next meeting

**SUBMISSION BY DR. THOMAS NZIOKI KIBUA**

The committee was informed that the causes of the fall of the Kenya Shilling were as follows:-

- (i) The world economic situation was deteriorating with America and the Euro zone both in a debt crisis. The Middle East and North Africa countries were having political instability. Since most of these countries are trading partners with Kenya, there was a drop in the earnings from export causing a current account deficit.
- (ii) The country was facing supply constraints; inadequate food supply and rising fuel prices. This increased the import bill creating a current account deficit.
- (iii) The actions of the government in 2011 were equivalent to fiscal indiscipline. The Economic Stimulus Programme, Women Enterprise Development Fund and Youth Enterprise Development Fund had become unproductive since the money spent was not equal to the output. This money found its way to consumption rather than development.
- (iv) The CBK had created an environment of weak monetary policy, creating excess liquidity. Banks were asking people to take loans without collateral. Much of these money could have caused inflation and also could have been used for speculation.
- (v) There had been heightened political temperatures with the coming of an election year and the ICC cases debate. Investors were divesting and foreigners were withdrawing their stakes in shares at the Nairobi Stock Market.

**Committee Observations**

From the interaction with Dr. Kibua, the committee observed the following:-

- (i) There had been an excess demand for dollars for importation. Foreigners who wanted to divest held their investment in Shillings, demanded for hard currency. Speculators were also in the market buying dollars with the idea that the Shilling was depreciating.
- (ii) There was excess liquidity in the market which was built by a loose monetary policy. With the drop in the interest rates, many Kenyans decided to transfer their money into dollars with the aim of speculating since the returns would be more lucrative than investing it. This caused divestiture since people needed their money in dollars. Speculative activities of individuals and banks made them to hoard dollars with anticipation that prices would go up.
- (iii) In the export sector, a lot of the investors were foreigners who were hoarding dollars from the sale of their produces abroad. Some Kenyans in the sector also kept their dollars abroad.

- (iv) The Country was importing a lot of fuel, food, cars from other parts of the world.
- (v) There was a drop in the inflows from export and remittances from the Diaspora. Many of the external investors felt Kenya was unstable.
- (vi) The actions and omission from the CBK were a clear cause of the problem. The CBK sent mixed signals in the market, speculators positioned themselves to take advantage of the reactions. The CBK also did not engage the commercial banks early enough.

### Committee Recommendations

- (i) Legislation should be put in place to discourage conspicuous consumption like importation of non-essential goods and basic commodities that can be obtained locally.
- (ii) Fiscal discipline should be instilled in the operations of the Treasury. The Treasury should develop good macroeconomic financial programs to guide the economy. There should be value for money from all government expenditures.
- (iii) The government should prioritize public project in a manner in which the economy doesn't overheat.
- (iv) CBK as a regulator should be in control of the market and not competing with the market players.
- (v) CBK should address this through its bank supervision department, on the problem of cartels in the market.
- (vi) CBK should be clear with its stand and should not send mixed signals in the market. A thorough understanding of the problem to be reacted to should be paramount.
- (vii) CBK should be up-to-date with the market operations of the banking industry since its timely interventions could save the country from a similar economic downturn.
- (viii) The independence of Central Bank should be upheld and the institution should know its responsibility and the consequence of not undertaking its duties diligently. The government should stop frequent interferences with CBKs operations.

### SUBMISSION BY SCHOOL OF ECONOMICS, UNIVERSITY OF NAIROBI

The School of Economics informed the Committee the following:-

- (i) The exchange rate price is determined by the market, for instance, the market for the dollar determines the price of the dollar. Demand and supply issues therefore play a significant role in determining the exchange rate price.
- (ii) An increase in the importation of commodities leads to an increase in the demand for the dollar. This increases pressure on the dollar. Under normal circumstances, there should'nt be a sharp rise in the exchange rate, a zigzag kind of graph. Something else may have failed in the market causing the market distortion experienced.

- (iii) The Central Bank of Kenya should have predicted possible failure and act fast but there was some laxity on the part of CBK.
- (iv) Importation of commodities that should not ordinarily be imported, like foodstuff, could have partly contributed to the decline of the Shilling.
- (v) The intervention measures taken by CBK will have serious impact on the growth of the economy as people will not have money to invest although the inflation will be tamed in the short run.
- (vi) The normal market forces could not be responsible for the decline of the Shilling to the levels experienced. Further, it was noted that international forces like the Euro crisis could not warrant the sharp decline of the Shilling.

#### **Causes of the decline of the Shilling:**

- (i) Policy lapse/ indecisiveness, discrete policy decision hence not predictable.
- (ii) Lack of clear monetary policies. CBK Governor intervened from the demand side ignoring the supply side.
- (iii) Ineffective monitoring of fundamental economic issues.
- (iv) Market distortion.

#### **SUBMISSION BY INSTITUTE OF ECONOMIC AFFAIRS**

The Institute of Economic Affairs informed the Committee the following:-

- (i) The Institute of Economic Affairs (IEA) is a civic forum that seeks to promote pluralism of ideas through open, active and informed debate on public policy issues. The IEA is independent of political parties, pressure groups, lobbies and any other partisan interests. IEA is liberal and non-partisan in orientation. The IEA's mandate is to promote informed debate on key policy issues both economic and political and to propose feasible policy alternatives in these areas. In addition, the institute provides research backup to policy makers including Members of Parliament.
- (ii) A rise in interest rates tends to contract the economy by appreciating the currency and reducing net exports. On the other hand, a decline in interest rates tends to expand the economy by depreciating the currency and raising net exports.
- (iii) Fiscal expansion pushes up interest rates. At higher interest rates, Kenyan securities become more attractive to foreign investors, who go to the foreign exchange markets to buy the Shillings with which to purchase the securities. This buying pressure drives up the value of the Shilling thus a fiscal expansion normally makes the exchange rate appreciate.
- (iv) Contradictory monetary policy reduces aggregate demand, which lowers both the real GDP and the prices. A monetary contraction raises interest rates, hence a tighter monetary policy attracts foreign capital into Kenya in search of higher rates of returns. The exchange rate therefore rises.
- (v) That, exports dampened due to the Euro zone uprising

## Recommendation

The Institute recommended tightening of monetary policies.

### SUBMISSION BY KENYA INSTITUTE FOR PUBLIC POLICY RESEARCH AND ANALYSIS (KIPPRA)

The Kenya Institute for Public Policy Research and Analysis informed the Committee the following:-

- (i) Kenya exchange rate is market determined and Central Bank of Kenya is only expected to intervene to correct erratic movements.
- (ii) The speed of depreciation in September 2011 was particularly too rapid and should have raised eyebrows earlier.
- (iii) The current account deficit has been worsening hence the pressure on the exchange rate. This is because import payments have been going up and export receipts have also been going up but at a lower rate.
- (iv) The introduction of the Economic Stimulus Programme in 2009 made the government expenditure rise rapidly.
- (v) The Government is in a tight fiscal position. The Central Government increased reliance on the Central Bank of Kenya advances. As a result, by the end of September 2011, overdraft facility stood at 25.4 billion.
- (vi) The monetary policy has been expansionary since 2008. By December 2010, reserve money increased by about 23%; credit expansion accelerated to 33% by July 2011; the rate of inflation continued to increase and inflationary expectations persisted.
- (vii) The Euro debt crisis did not affect Kenya as the exchange rate against the Euro was depreciating.
- (viii) The Central Bank of Kenya recognized that the forex market was under pressure as early as June 2011. They then focused on streamlining the Overnight Discount Window (ODW) borrowing. Bank Circular (BC) no. 5 raised the ODW rate to 8%. Two weeks later on 11<sup>th</sup> July BC no. 6- ODW reduced to 6.25 and access to ODW limited. August 12<sup>th</sup> vide BC no. 8, ODW revised to take effect from 15<sup>th</sup> August 2011.
- (ix) On 26<sup>th</sup> August BC no. 9 computation of the differential between interbank and CBR were revised. These changes pushed the inter-bank rate to about 26% during the last week of August before falling to 12% during the first week of September and further to about 6% during the following week.
- (x) Central Bank of Kenya made statements that it would sell forex directly to importers and changed the same before it was implemented.
- (xi) The policy inconsistencies by the Central Bank of Kenya made investors think policy makers are not able to deal with the problem. Besides, public statements by opinion shapers like African Development Bank also contributed to the same.
- (xii) Market manipulation could have been a factor that worsened the already delicate situation.

**KIPPRA Recommendations**

- (i) Closer bank audits should be strengthened.
- (ii) Expenditure on non-essential or priority items should be reduced in the short term.
- (iii) Monetary policy should be tightened further.
- (iv) Concessionary borrowing (IMF and other Donors) should be increased.
- (v) Kenya should enhance competitiveness and exploit opportunities for import substitution in the medium to long-term period.

**MIN. NO.22/2011:**

**ADJOURNMENT**

There being no other business and the time being Thirty minutes past four the meeting was adjourned.

SIGNED.....  
(CHAIRMAN)

DATE. 07/02/12.....

MINUTES OF THE 6<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON TUESDAY, 6<sup>TH</sup> DECEMBER, 2011 IN THE 7<sup>TH</sup> FLOOR CONTINENTAL HOUSE MAIN PARLIAMENT BUILDINGS AT 10.00A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Adan Bare Duale, M.P.

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.

IN ATTENDANCE

Mr. James Ginono  
Mr. Benjamin Ng'imor  
Mr. Gilbert Kipkirui

NATIONAL ASSEMBLY

- Clerk Assistant  
- Fiscal Analyst  
- Fiscal Analyst

IN ATTENDANCE

Mr. Micah Cheserem

FORMER CBK GOVERNOR

IN ATTENDANCE

Ms. Ruth Mwaniki  
Mr. Kenneth K. Murimi  
Mr. Peter Ochieng  
Ms. Lucy Waithaka  
Ms. Christine Mwaka

EXPORT PROMOTION COUNCIL

- Chief Executive Officer

Mr. Maurice Otieno  
Mr. M. O. Abuom

IN ATTENDANCE

Mr. Muriithi Ndegwa  
Mr. Orumoi Taja Jonah  
Mr. Michael Kiungu

IN ATTENDANCE

Eng. Kaburu Mwirichia  
Eng. Linus Gitonga  
Mr. Cyprian Nyakundi

IN ATTENDANCE

Mr. Julius Korir  
Mr. Mwalimu Musee  
Mr. Rogers Amisi  
Mr. James Njuguna  
Mr. Ken Manyala

IN ATTENDANCE

Mr. Ephraim G. Kanake

KENYA TOURISM BOARD

- Managing Director

ENERGY REGULATORY COMMISSION

- Chief Executive Officer

KENYA INVESTMENT AUTHORITY

- Chief Executive Director

CONSUMER FEDERATION OF KENYA

- Chairman

MIN.NO.23/2011

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairperson informed the former CBK Governor, the Export Promotion Council, the Kenya Tourism Board, the Energy Regulatory Commission, Kenya Investment Authority and Consumer Federation of Kenya teams that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO/24/2011

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:-

(i) Meeting with:-

- the Kenya Investment Authority;
- the Energy Regulatory Commission;
- the Kenya Export Promotion Council;
- the Kenya Tourism Board;
- Consumers Federations of Kenya; and
- Mr. Micah Cheserem.

(ii) Any Other Business

(iii) Adjournment and date of the next meeting

MIN. NO/25/2011

MEETING WITH KENYA INVESTMENT AUTHORITY,  
ENERGY REGULATORY COMMISSION, KENYA  
EXPORT PROMOTION COUNCIL, KENYA TOURISM  
BOARD, CONSUMERS FEDERATIONS OF KENYA  
AND MR. MICAH CHESEREM

The Committee resolved to take submission from each group at a time.

**SUBMISSION BY KENYA TOURISM BOARD**

The Kenya Tourism Board informed the Committee the following:-

- (i) The Kenyan Shilling exchange rate continued to weaken against all major world currencies in the third quarter of July to September 2011 reaching 7.2%.
- (ii) The depreciation reflected a widening of the current account deficit indicating a high oil import bill and imports of infrastructure development.
- (iii) The Shilling manifested volatility attributed to the Euro sovereign debt crisis and currency speculation activities.
- (iv) Monetary policy actions measures in the foreign exchange market were put in place to stabilize the Shilling.
- (v) In September 2011 the Monetary Policy Committee (MPC) raised Central Bank rate (CBR) by 75 basis points from 6.25 % to 7.00% so as to tighten the Kenya Shilling liquidity in the domestic money markets.
- (vi) The Shilling appreciated against all major world currencies during the months of October 30<sup>th</sup> to November 9<sup>th</sup>.
- (vii) There are positive effects of the depreciating Shilling in the tourism sector which included:-

- a) making the destination more affordable in terms of a direct expenditure as locally manufactured goods were viewed as cheap
  - b) increased revenues because when converting the Shilling into major world currencies the profits are larger. This applied to hoteliers, tour operators and airlines
- (viii) There were negative effects of the depreciating Shilling in the tourism sector which included:-
- a) reduced revenue margins
  - b) higher domestic rates hence reduced appeal for domestic tourism in leisure, business and conferencing terms

### **Recommendations by Kenya Tourism Board**

- (i) Consumer protection to reduce the effects of the rising inflation leading to reduction in the cost of goods, services, production and operations
- (ii) Investment in the tourism marketing to maximize on the destination appeal as a result of the destination being perceived to be cheaper due to the depreciating Shilling
- (iii) Investment in renewable energy and alternative energy solutions
- (iv) Strict regulations of the banking sector to control interest rates charged on players in the sector to reduce the cost of borrowing as these costs are inevitably forwarded to the consumer without a commensurable benefit in value added.

### **SUBMISSION BY EXPORT PROMOTION COUNCIL**

The Export Promotion Council informed the Committee the following:-

- (i) Limited export product range and reduced foreign exchange inflows reduced the national capacity to cover the import bill from the exports proceeds and also constrained the capacity of the treasury and CBK to employ effective monetary and fiscal policies that will ensure a stable exchange rate.
- (ii) Uncertainty over the Arab spring in the Middle East and North Africa states caused a rise in oil prices, which resulted in a larger import bill.
- (iii) Kenya had been in a heated political environment for the better part of 2011 with the upcoming elections and the ICC trials debate. This made investors who anticipate election violence to take off causing capital flight.
- (iv) There was speculation by importers so as to get favorable forward purchases in the wake of a depreciating shilling.
- (v) The oscillating shilling created an uncertain environment for production and other structural issues. It was conducive for planning for production. This negatively impacted on long term investments and also induced capital flight.

- (vi) The weak shilling had a positive impact on exports earnings. But this advantage has not been fully felt in the market since the Kenya exports raw products with limited valued addition. Kenya lacks high value capital products.

### **Committee Observations**

- (i) Kenya has become an import centered economy.
- (ii) Kenya imports approximately USD 1.2 billions compared to exports of between USD 600-800 Million per month.
- (iii) Value addition is not done on commodities being exported from the country.
- (iv) That the Horticulture sector is hard hit by the crisis.

### **Committee Recommendations**

- (i) A seminar be organized between the Export Promotion Council and all Members of Parliament so that they can be sensitized on the mandate of the council.
- (ii) The country should start a trade show and exhibitions on a monthly basis to showcase Kenyan products to the world.
- (iii) Measures be put in place to ensure that value addition is done in all the commodities being exported from the country.

### **SUBMISSION BY ENERGY REGULATORY COMMISSION**

The Energy Regulatory Commission informed the Committee the following:-

- (i) The energy (Petroleum pricing) Regulations, 2010 was gazetted as Legal Notice No. 196 of 2010 on 3<sup>rd</sup> December 2010.
- (ii) The Commission implemented the regulations with effect from 15<sup>th</sup> December 2010 during its first price publication, the price of super petrol in Nairobi dropped by Kshs. 6.27 while that of Automotive diesel by Kshs. 4.05 per litre.
- (iii) The Energy Regulatory Commission calculates and publishes the recommended maximum retail prices of petroleum in accordance with the regulations.
- (iv) The maximum pump prices are composed of the costs incurred in the petroleum supply chain and the marketing margins for the importers and retail traders.
- (v) The current problem of high prices of fuel is being experienced globally and has been rising since 2010.
- (vi) The imported petroleum products are paid for in US Dollars.
- (vii) It is important to note that the exchange rates applicable in a pricing month are exchange rates for the previous month when petroleum products are imported to the Country.
- (viii) About 60% of the petroleum products used in the country are imported as refined products while the balance of 40% is imported as crude oil which is refined locally.

- (ix) The taxes and levies charged on petroleum products are fixed amounts and do not vary with the cost of products and that this has remained unchanged for the last several years.
- (x) The cost of transportation and distribution of petroleum through the pipeline and by road from Mombasa to retail outlets in Nairobi has remained unchanged at about Kshs. 4 per litre
- (xi) The allowed gross margins are to cover the operational expenses and mark up for marketers and dealers of petroleum products which include operational expenses, cost of financing imports and cost of maintaining facilities including pump stations and private depots.
- (xii) There has been an increase in pump prices of 32.0% for super petrol, 30.7% for diesel and 25.1% for kerosene and these changes reflect the increases in the cost of products.
- (xiii) That because imported petroleum products is paid for in US Dollars this led to imports being more expensive in KES terms because of the decline in KES.

#### **SUBMISSION BY MICAH CHESEREM**

Micah Cheserem informed the Committee the following:-

- (i) The principal functions of CBK are to maintain price stability and regulate the banking system.
- (ii) There are two levels of inflation which includes an overall inflation and the underlying inflation.

Central Bank of Kenya should only be held responsible for managing underlying inflation which is subject to monetary policy. Other factors that cause overall inflation such as food shortages and fuel price increases are outside the control of the Central Bank.

- (iii) The Central Bank of Kenya has very capable economists. It is most surprising that they allowed a very expansionary regime of money supply to persist for so long. It appears their advice may have been ignored.
- (iv) The main cause of the recent Shilling depreciation included:-
  - Deteriorating current account deficit. Falling exports and rising imports.
  - Purchase of dollars by the CBK at a time when there was already a shortage of forex.
  - Pronouncement that CBK was not going to intervene to save the Shilling from depreciation. This encouraged speculators.
  - Purchase and repatriation of dollars by foreigners and some locals who had invested in Treasury Bills following very low levels of interest rates opted to invest their funds in overseas money markets earning positive interest rates.

## Committee Recommendations

- (i) CBK economists should explain to the Parliamentary Committee the advice they made to the Monetary Policy Committee to mop up excess liquidity.
- (ii) CBK should not make its intervention known with regard to interventions in the forex market.
- (iii) Raise the Central Bank Kenya lending rate but not too excessive as this will damage the economy. Both the public and the private sectors will be adversely affected
- (iv) Everyone to exercise patience since impact of monetary policy actions take time to produce results.
- (v) Government to be encouraged to implement austerity measures so that they can reduce their borrowing from the money market. This will ease pressure on interest rates.
- (vi) Consider the pros and cons of including external members in the Monetary Policy Committee.
- (vii) CBK should not allow the Shilling to over-appreciate as this will discourage tourists and make Kenyan exports non-competitive.
- (viii) CBK should be appearing before the relevant Parliamentary Committee on a regular basis, say quarterly or half-yearly, to explain the performance on their two core mandates of price stability and the spirit of openness and accountability in the management of public finances as required by our new constitution.
- (ix) Future appointments to the positions of Governor and Deputy Governor should be through a vigorous competitive process with a panel to interview the prospective candidates.

## SUBMISSION BY KENYA INVESTMENT AUTHORITY

Kenya Investment Authority informed the Committee the following:-

- (i) The Kenya Investment Authority is a statutory body established by the Investment Promotion Act (No. 6 of 2004) with the main objective of promoting investments in Kenya. It is responsible for facilitating the implementation of new investment projects, providing after care services for new and existing investments, as well as organizing investment promotion activities both locally and internationally. The core functions of the Authority include policy advocacy, investment promotion, investment facilitation which includes investor tracking and after care services.
- (ii) The Investment Promotion Act be amended to provide for mandatory registration of all investors coming to Kenya; registration of portfolio investment; registration of capital flows
- (iii) The Authority be facilitated to carry out promotion of Kenya as an investment destination.

## SUBMISSION BY CONSUMER FEDERATION OF KENYA

The Consumer Federation of Kenya informed the Committee the following:-

- (i) The cost of living sky rocketed and consumers were not able to access basic needs due to the high cost of these commodities.
- (ii) Due to the decline of the Shilling, imports become expensive making life unbearable.

**MIN. NO/26/2011: ADJOURNMENT AND DATE OF NEXT MEETING**

There being no other business and the time being Thirty Six Minutes past Two the Meeting was adjourned until Thursday 8<sup>th</sup> December, 2011 at 10.00am.

SIGNED.....  
(CHAIRMAN)

DATE..... 07/02/12 .....

MINUTES OF THE 7<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON THURSDAY, 8<sup>TH</sup> DECEMBER, 2011 IN THE 5<sup>TH</sup> FLOOR CONTINENTAL HOUSE MAIN PARLIAMENT BUILDINGS AT 11.15 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Adan Bare Duale, M.P.

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. James Ginono

NATIONAL ASSEMBLY

- Clerk Assistant

IN ATTENDANCE

Mr. Joseline Oyai  
Ms. Beatrice Memo  
Mr. John Njiraini  
Mr. Kennedy Onyonyi

KENYA REVENUE AUTHORITY

IN ATTENDANCE

Eng. Joseph Atongei  
Mr. Justus Nyarandi

KENYA PORTS AUTHORITY

IN ATTENDANCE

KEPSA

Mr. Kariithi Murage Murimi

IN ATTENDANCE

EXPERT

Dr. David Ndii

MIN.NO.27/2011

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairperson informed the Kenya Revenue Authority, Kenya Ports Authority, Kepsa and the Consultant that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO/28/2011

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:

(i) Meeting with:-

- the Kenya Revenue Authority;
- the Kenya ports Authority
- KEPSA; and
- Dr. David Ndii.

(ii) Any Other Business

(iii) Adjournment and date of the next meeting

MIN. NO/29/2011

MEETING WITH KENYA REVENUE  
AUTHORITY, KENYA PORTS  
AUTHORITY, KEPSA AND DR. DAVID NDII

The Committee resolved to receive submission from each group at a time;

#### **SUBMISSION BY DR. DAVID NDII**

Dr. Ndi informed the Committee the following:-

- (i) The Kenya Shilling has continued to depreciate against major trading currencies since March 2011.
- (ii) The depreciation was characterized by increased volatility (big swings) since March 2011.
- (iii) The trends of depreciation and volatility peaked in September/October 2011, promoting a public outcry as well as a policy response.
- (iv) The policy response of sharply increasing the interest rates seems to have stabilized the situation but at a high cost.
- (v) The instability had two drivers namely the economic fundamentals and the country's fiscal and monetary policy.

#### **SUBMISSION BY KENYA PRIVATE SECTOR ALLIANCE**

Kenya Private Sector Alliance informed the Committee that the key areas and factors to look into towards stabilizing the Shilling are as follows:-

##### **(i) Infrastructural development**

- It is important to have an improved and efficient infrastructure to the growth of the economy. Good road network for example, reduces the fuel wasted in traffic jam.  
High inflation increases the cost of projects leading to stoppage of some when the government cannot pay the contractors in good time.
- The foreign funded project are not fully paid for and the government has to buy dollars to pay for its part. This raises the demand for the dollar hence pushing inflation further high. Some of these projects should be sub-let to local contractors to reduce the demand for foreign currency.
- There is a need to have policy guidelines on how the projects towards infrastructural development are implemented. There should be a mechanism to look into the mega projects and their execution processes.

#### **Recommendations**

- There is need to identify what can be imported for the projects and what should be produced locally.
- Some machinery from local companies should be used to avoid using dollars to import machinery while they are locally available. To this effect, the local machines need to be given incentives so as to make the imported ones more

expensive and hence unattractive to the local industry. These incentives make inputs cost effective and the local production inexpensive.

- There should be a reduction in the cost of energy.
- Kenyans should be encouraged to buy what is Kenyan though the market is liberalized and this should not infringe people's right to buy anywhere.
- Foreign contractors need to share their work with local contractors to enhance knowledge transfer.

**(ii) Cost of running the government:**

- The cost of running the government is too high putting pressure on the scarce resources. The Commission Revenue Allocation should look into how well the revenue is utilized to ensure that the excess money is channeled into infrastructural development.
- There is need to enhance transparency and do away with corruption and mismanagement of public funds.
- The devolved government should be effected in phases for cost efficiency and to maintain stability.
- The central government should deal with policies, resource mobilization and monitoring and evaluation. The rest should be done by the county government to cut on the cost of running the government.

**(iii) Private sector efficiency in production**

- The increased cost of goods partly caused by inefficiency in production was passed on to the consumer. The private sector should ensure efficiency in production.
- There is need to improve efficiency of Kenya pipeline as well as the entire supply chain to cut on energy cost.
- Harnessing of coal should be fast-tracked to enhance development of power in a different way and to cut on the energy costs incurred through importation.
- There is need to harmonize companies involved in energy supply and target tariffs to avoid competition. To this effect, a committee should be formed in both public and private sector to regulate competition.
- There is need to improve infrastructure efficiency and capacities by giving incentives to companies whose vehicles reduce congestion on the roads, such as double-decker buses.
- There should be sanction measures for engineers who carry out their projects inefficiently.
- The education sector needs to set up high standards of education to be able to supply the region with skills needed for efficiency as well as enable Kenyans acquire international contracts as a way of earning foreign currency. Education tourism promotion may also boost the economy.
- There is need for local IT companies to partner with international companies for technology transfer and to enable the companies acquire international projects.

- The impact that cartels have on the economy should be looked at intensively and independently. The Competition Authority is yet to make an impact.
- The import storage facility in Mombasa should be commissioned to cut on the additional costs of imports incurred at the store.

**(iv) Central Bank Governance Structure**

- A commission should be formed to which the Central Bank reports periodically. This should be an independent body. This is due to the fact that the CBK Governor chairs the MPC as the policy making organ and he is also the implementer. The nomination of the members of the MPC is also shrouded in secrecy hence bringing in suspicion.
- Central Bank should address and interrogate any political pressures on the Shilling.
- Central Bank should look into the volatility of the exchange rate and put in place measures to enhance confidence in its consistency.
- There should be a balance between the fiscal and monetary policies and debt management.
- The Central Bank Act should be amended in the section of the MPC composition.

**SUBMISSION BY KENYA PORTS AUTHORITY**

Kenya Ports Authority informed the Committee the following:-

- (i) The first ten months of 2011 registered a higher 4.3 per cent compared to the same period in 2010, with output increasing from 15.45 million tons in the period January – October 2010 to 16.11 million tons during a similar period in 2011. Container traffic recorded a higher growth of 12.9% increasing over the period from 571,602 TEU in 2010 to 645,282 TEU in 2011.
- (ii) Port traffic was heavily skewed in favour of imports, a trend that had been growing from year 2001. This share was 84% imports and 14.5% exports in 2011.
- (iii) The volume of grain imports had been increasing over the years, however, the imports for year 2010 did not reach the 2009 figures when a record of 3.1 million tones were handled due to relief imports for the region. There was also no change in tariff for grain importers.
- (iv) To cushion Kenyans against the effects of the decline of the Shilling, Kenya Ports Authority provided 24/7 port operations to ensure that cargo do not incur charges, maintained the same charges as per the tariff effective 1<sup>st</sup> of February 2008 with minor amendments, removed scanning verification charges, contracted eight CFSs that helped to decongest the Port and facilitate cargo movement,.
- (v) The Authority hoped to upgrade the port to an E-port by 2012.

**Conclusions**

- (i) There was direct positive relationship between currency fluctuation and the price of imports. As the Shilling depreciated, the imported goods became expensive and exports cheaper, leading to increased exports and reduced imports. More Shilling was needed to import the same volume of goods resulting in high import costs, hence high prices to remain profitable.
- (ii) A number of projects were contracted out in foreign currency and the appreciation of the currency led the Authority to pay more. The Authority's recurrent expenditures such as fuel for equipments and maintenance of spare parts that are purchased overseas were also affected.
- (iii) Exports between 2008-2009 were affected by world economic downturn.
- (iv) The working hours between 6 am and 10 am are underutilized in the port.

### **Committee Recommendation**

The port management should provide incentives for clients to collect goods between 6 am and 10 am.

### **SUBMISSION BY KENYA REVENUE AUTHORITY**

Kenya Revenue Authority informed the Committee the following:-

- (i) During the period July to November 2011, KRA collected Kshs266.7 billion (of which 252.2 billion was exchequer revenue) compared to Kshs237 billion in a similar period of FY 2010/2011.
- (ii) Petroleum taxes recorded a growth rate of 1.2 % in the period July – November 2011, compared to a similar period in 2010/11.
- (iii) During the period July – November 2011 indirect taxes registered a decline of 3.4% compared to a similar period in 2010/11. Principal under performers were VAT, Domestic Excise and Excise on air time.
- (iv) Since September 2009, the Shilling had been depreciating against the major currencies and particularly the dollar. This affected the FOB value eventually influencing volumes purchased for importation to Kenya.
- (v) The imports and exports volumes over 2011 to the end of November grew by 11.1% and 14.6% respectively.
- (vi) The taxpayers who heavily depend on imported raw materials or products and services were caused to increase the cost of production. This mostly resulted in reduced sales revenues and VAT collections.

### **Conclusion**

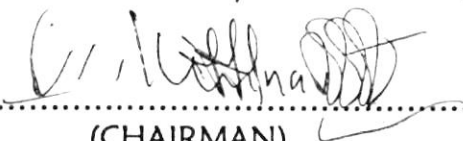
- (i) The poor performance in petroleum taxes was attributed to the rising prices of oil in the world oil markets which undermined import volumes and depreciation of the Shilling against other major currencies.

- (ii) The decline in VAT was largely attributed to the rolling back of withholding VAT which allowed for the VAT to be withheld and remitted directly. VAT was also impacted on by the exchange rate which by raising import values increased the deductions on import VAT. Excise duty on domestic products was affected by a drop in production quantities which could not be attributed to the exchange rate movements. Excise duty on airtime poor performance was a result of the price war in the telecommunications.
- (iii) The exchange rate depreciation kept pace with the inflation rate.
- (iv) The value of growth in the imports and exports volumes over 2011 was primarily driven by the depreciation of the currency and unit price of imports.
- (v) The depreciating Shilling resulted in higher revenue outrun as importers paid more Shilling for dollar.
- (vi) There was however a decline in volume of imports as was shown by Import Declaration Fees. In addition, the high inflationary environment, the exchange rate gains were eroded by inflationary pressure.
- (vii) The weakening Shilling piled pressure on sales of used cars whose orders dropped by 18.2% in the third quarter, thus rising the cost of used cars.
- (viii) The weakening Shilling denied the economy the benefits of the ongoing fall in global crude prices, despite the fall in the international oil markets.
- (ix) The taxpayers who heavily depend on imported raw materials increased the cost of production thus impacting negatively on domestic taxes.
- (x) Those tax payers with loans denominated in foreign currency incurred foreign exchange losses which affected profitability.
- (xi) Banks may have realised foreign exchange gains which impacted positively on their profitability.
- (xii) The Central Bank measure to minimize exchange rate volatility through increased bank rate caused banks to increase their lending rate which may have resulted in bad debts due to defaults, reduced borrowing, which in the long run would impact their profitability.
- (xiii) The key requirement for revenue performance is stability of key economic parameters so that business does not adopt a wait and see attitude with respect to investment and expenditure.

MIN. NO/30/2011

ADJOURNMENT AND DATE OF NEXT MEETING

There being no other business and the time being Twenty Minutes past Two O'clock the meeting was adjourned until Tuesday 13<sup>th</sup> December, 2011 at 10.00am.

SIGNED.....  
  
 (CHAIRMAN)

DATE. 07/02/12.....

MINUTES OF THE 8<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON TUESDAY, 13<sup>TH</sup> DECEMBER, 2011 IN THE CONFERENCE HALL COUNTY HALL MAIN PARLIAMENT BUILDINGS AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Benedict Gunda, M.P.

ABSENT WITH APOLOGY

The Hon. Emilio Kathuri, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Benjamin Langat, M.P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Benjamin Ngimor  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

MIN.NO.31/2011

PRELIMINARY

The meeting started with a word of prayer.

MIN. NO.32/2011:

ADOPTION OF AGENDA



MINUTES OF THE 9<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON WEDNESDAY, 14<sup>TH</sup> DECEMBER, 2011 IN THE CONFERENCE HALL COUNTY HALL MAIN PARLIAMENT BUILDINGS AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Benjamin Langat, M.P.

ABSENT WITH APOLOGY

The Hon. Emilio Kathuri, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Moses Lesonet, M.P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

IN ATTENDANCE

Dr. Gedion Muriuki, MBS  
Mr. Sam Birech  
Mr. Jeff Odundo  
Mr. Charles Kamanda

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

COOPERATIVE BANK LTD

- Group MD and C.E.O  
- Director, Retail Banking  
- MD Kingdom Securities Ltd  
- Treasurer

**IN ATTENDANCE**

Mr. Adan Mohamed  
Mr. Antony Mulisa

**BARCLAYS BANK LTD**

- Managing Director  
- Country Treasurer

**IN ATTENDANCE**

Mr. Michael Wachira  
Mr. Paul Njaga  
Mr. Robert Otieno

**EQUITY BANK LTD**

- Group Treasury Director  
- Chief Finance Officer  
- Group Treasurer

**IN ATTENDANCE**

Mr. Paul Tikani  
Mr. Shalin Gudka

**KENYA COMMERCIAL BANK**

- Chief Operations Officer  
- Director Treasury

**IN ATTENDANCE**

Mr. Frank Ireri

**HOUSING FINANCE BANK**

- Chief Executive Officer

**MIN.NO.36/2011**

**PRELIMINARY**

The meeting started with a word of prayer. After introduction, the Chairperson informed the Cooperative Bank Ltd, Barclays Bank Ltd, Equity Bank Ltd, Kenya Commercial Bank and Housing Bank teams that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

**MIN. NO.37/2011**

**ADOPTION OF AGENDA**

The Agenda of the Sitting was adopted by the Members present as follows:

- (i) Meeting with major Banks
- (ii) Any Other Business
- (iii) Adjournment

**SUBMISSION BY CO-OPERATIVE BANK**

Co-operative Bank informed the Committee the following:-

- (i) The causes of the exchange rate depreciation against major foreign currencies were as follows:
- There was an imbalance in the country's economy with a growing gap between imports and exports.
  - The country had high dependency on oil imports.
  - Drought in the country which ensured that the export arising from farming went down.
  - Lower earnings from other traditional export commodities such as Coffee and pyrethrum.
  - Escalating food prices and high import of oil prices.
  - 2009/2010 Economic Stimulus Programs increased the amount of money in circulation.
  - Good credit support by commercial banks which led to the growth of the economy.
- (ii) The increase of the Central Bank Rate (CBR) to 18% had the following impact to the general growth of the economy.
- The banks stopped credit growth.
  - Investors were moving into fixed income securities as the NSE index was at a low of 3110 points from the index of 4621 at the beginning of 2011.
- (iii) The Bank requested the Committee to follow up among other issues:
- Specific measures to assist the government manage the overall level of debt.
  - Encouragement in value addition of Kenyan produce.
  - Enhancement of domestic energy production to reduce generator oil import.
  - Government policy to hinder mass importation of second hand vehicles.

**SUBMISSION BY BARCLAYS BANK**

The Bank informed the Committee the following:

- (i) The causes of the exchange rate depreciation against the foreign currency and inflation were as follows:
- The inflation was caused by the shortage of food occasioned by inadequate rainfall hence increasing the prices of food.
  - The CBK policy which worked towards balancing growth objectives lead to the increase in demand for commodities.
- (ii) The increased rates by Central Bank to 16.5% had the following impact;
- It led to the increase in interest rates across all money market variables.

- Commercial Banks increased their base by an average of 5% leading to an increase in lending rates and deposit rates.
  - The increase in interest rates eliminated the international players from the Kenyan market.
- (iii) The bank did not make any significant profits during the period and it did not borrow or buy any monies of any currency from the CBK.
- (iv) The bank held during the period, approximately USD 300 million as customer deposits and the fluctuation was between USD 260 Million and USD 330 Million.

### **SUBMISSION BY EQUITY BANK**

Equity Bank informed the Committee the following:-

- (i) The causes of the exchange rate depreciation against the foreign currency and inflations were as follows:-
- High inflation rate
  - Fragile global economic environment
  - Arab spring
  - Negative current account balances
  - The Shilling is traded more easily
  - Rapid public and private sector credit growth
  - Short term effects of the massive investment conducted by the republic.
- (ii) The interest rate for the bank is 25% on the maximum
- (iii) Equity bank took the following measures:
- It has focused on the base of the pyramid and concentrated in the low income earners
  - It conducted proprietary trading.

### **SUBMISSION BY KENYA COMMERCIAL BANK**

Kenya Commercial Bank informed the Committee the following:-

- (i) The import bill was double the export bill.
- (ii) Most of the products in the Kenyan Market are imported.
- (iii) The Egyptian crisis affected the export bill of the country because Egypt is a major consumer of the Kenyan Tea.
- (iv) The bank did not take any speculative position and even when taken it is in accordance with the rules and regulation in place.
- (v) The banks are smaller players in the wider market.
- (vi) The lending is done to facilitate export growth.

**SUBMISSION BY HOUSING FINANCE CORPORATION**

Housing Finance informed the Committee the following:-

- (i) The company gives secured loans to clients and it gives long term lending.
- (ii) Customers can borrow with as little as 7% interest rate
- (iii) The interest rate for Housing Finance Corporation (HFC) is at 23%
- (iv) That HFC has gone through the pain of non-performing loans and the corporation was affected by the recent demolition in Syokimau and Eastleigh where its customer's properties were affected
- (v) The Housing Finance Corporation is legally allowed by the Finance Bill of 2010 to run current accounts for customers
- (vi) That HFC has a savings account portfolio of up-to 55% of its resources across the country; corporate bonds of approximately Kshs. 7 billion; bank loans of 30% whereas the corporation has the rest in terms of share capital

**The Committee requested the banks to avail the following;**

- (i) Resubmit their presentation officially through the Clerk within 72 hours.
- (ii) Attach any correspondences they received from the CBK and the responses they issued.
- (iii) A report of the amount of the forex held in the bank in the past 12 months and the profits realized by the bank in the last 3 quarters.

MIN. NO.39/2011:

ADJOURNMENT AND DATE OF NEXT MEETING

There being no other business and the time being Twenty Minutes past Four the meeting was adjourned.

SIGNED.....

  
(CHAIRMAN)

DATE.....

07/02/12

MINUTES OF THE 10<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON THURSDAY, 15<sup>th</sup> DECEMBER 2011, IN THE CONFERENCE HALL COUNTY HALL MAIN PARLIAMENT BUILDINGS AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Benedict Gunda, M.P.

ABSENT WITH APOLOGY

The Hon. Emilio Kathuri, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Benjamin Langat, M.P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Mr. Habil Olaka

KENYA BANKERS ASSOCIATION

- Chief Executive Officer

IN ATTENDANCE

Mr. Solomon Alubala

ASSOCIATION OF FOREX DEALERS

-

**MIN. NO.40/2011:**

**PRELIMINARY**

The meeting started with a word of prayer. After introduction, the Chairman informed the Kenya Bankers Association and Association of Forex Dealers teams that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

**MIN. NO.41/2011:**

**DOPTION OF AGENDA**

The Agenda of the Sitting was adopted by the Members present as follows:

- (i) Meeting with the Kenya Bankers Association (KBA) and the Association of Forex Dealers
- (ii) Any Other Business
- (iii) Adjournment

**MIN. NO.42/2011:**

**MEETING WITH KENYA BANKERS ASSOCIATION  
AND ASSOCIATION OF FOREX DEALERS**

**SUBMISSION BY KENYA BANKERS ASSOCIATION (KBA)**

- (i) Central Bank on realizing that the decline was reaching unprecedented levels it institutionalized a policy through the MPC which was simply a monetary tightening stance. In quick succession the CBK adjusted its rate from 7% to 11% in October 2011 to 16.5% in November 2011 and then to 18%. In addition, the Cash Reserve Ratio was increased from 4.75% to 5.25% with effect from 15 December 2011.
- (ii) The Kenya Bankers Association responded to the stance taken by the MPC as hereunder:
  - Extended loan repayment period so as to keep the repayment installment at the level before the high interest regime.
  - Capped the maximum increase in the loan repayment amount to 20% and extended the repayment period to fit the required installment amount.

- Absorbed the additional costs from changes in the macroeconomic environment.
  - Banks were not to raise interest rates despite the recent further increase in CBR by 1.5%. The banks were expected to absorb any market rate increase with consequent increase in cost of funds for the banks.
  - Waiving of penalty interest on early repayment.
- (iii) There is a tendency in the market to anticipate changes by the MPC.
- (iv) The pressures on the Shilling was mainly from the supply side(oil, food and the Arab uprising)
- (v) There are consequences to borrowers when the bank uses the inter-bank window rate at 30%; however the rate was reduced to 17%.
- (vi) The cost of transporting money from the CBK to different bank branches is high and so cheque truncation process (RTGS) was introduced.

#### **SUBMISSION BY ASSOCIATION OF FOREX DEALERS**

The Association of Forex dealers informed the Committee the following:-

- (i) CBK bought USD 700 million directly from the market.
- (ii) The IMF had given Kenya a condition of a 6 month credit cover.
- (iii) The reserves held by the CBK directly contributed to the current account deficit in the country.
- (iv) There was a loose monetary policy of up to 1% which was a loophole that was used by greedy investors.
- (v) There were low interest rates for so long which could not be sustained.
- (vi) The inflation came from the supply side and CBK did not act early enough.
- (vii) There are skill gaps in the MPC and members of that Committee do not understand the movements and major drivers of exchange rates.

**MIN. NO.43/2011 : ANY OTHER BUSINESS**

There arose no any other business.

**MIN. NO.44/2011 : ADJOURNMENT AND DATE OF NEXT MEETING**

There being no other business and the time being Twenty Minutes past Eleven O'clock the meeting was adjourned until Friday 16<sup>th</sup> December, 2011 at 10.00am.

SIGNED.....  
(CHAIRMAN)

DATE. 07/02/12.....

MINUTES OF THE 11<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON  
THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON  
FRIDAY, 16<sup>th</sup> DECEMBER, 2011 IN THE CONFERENCE HALL COUNTY HALL MAIN  
PARLIAMENT BUILDINGS AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Adan Bare Duale, M.P.

ABSENT WITH APOLOGY

The Hon. Shakeel Shabbir, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

IN ATTENDANCE

Mr. Fred Ouko  
Mr. Kenneth Kanyarati

IN ATTENDANCE

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

CFC STANBIC BANK

- Director Risk  
- Head Legal and Compliance

FAMILY BANK

Mr. David Thuo  
Ms. Kanini Kioko

- Treasury Advisor  
- Treasurer

MIN. NO.45/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairman informed the CFC Stanbic Bank and Family Bank teams that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO.46/2011 :

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:-

- (i) Meeting with the CFC Stanbic Bank and Family Bank
- (ii) Any Other Business
- (iii) Adjournment

MIN. NO.47/2011:

MEETING WITH THE CFC STANBIC BANK AND FAMILY

**SUBMISSION BY CFC STANBIC BANK LTD**

CFC Stanbic Bank informed the Committee the following:-

- (i) The decline in the local currency in relation to the other major world currencies was due to the following factors:
  - The Arab uprising in the Middle East especially Egypt which is a major importer of Kenya tea resulting in a decline in the export bill of the country in such traditional markets
  - Drought affected the production of farm produce and reduced the production of horticulture and other inputs
  - The Europe economic crisis affected the horticulture market.
  - Increased infrastructural development in the country increased the demand for dollars and other foreign currencies leading to a decline of the Kenyan Shillings.

- Importers panicked and bought dollars from the banks and held them in-order to speculate.
  - There was an increase in the price of oil leading into unbalanced Balance of Payment.
- (ii) Kenya had no exchange Control Commission and forex trading was done on a supply and demand basis
  - (iii) Since forex trading is an open system there is a possibility that foreign investors could have resorted into arbitrage.
  - (iv) The bank was not sure if the CBK's Monetary Policy Committee did its work well.
  - (v) The bank received unscheduled visits from CBK after which they were suspended temporarily from the interbank exchange window.
  - (vi) CBK issued the bank with a warning letter.

### **Committee Observations**

The Committee observed the following:-

That CFC Stanbic bank was one of the Banks that was engaged in speculative tendencies

**The Committee directed the bank to avail the following:-**

- (i) The warning letter received from the regulator and the response they gave
- (ii) The findings of the regulator upon examining the bank books

### **SUBMISSION BY FAMILY BANK LTD**

Family Bank informed the Committee the following:-

- (i) The Shilling depreciated steadily in the month of October and November 2011 leading to the rise in inflation and low interest rates.
- (ii) The regulator was slow to act to help the situation.
- (iii) There was need for the government to let out information to the wider public on the situation and strongly stabilize the prices of commodities and attract the foreign exchange.
- (iv) There was need to identify the drivers of inflation and influences of foreign exchange rates.
- (v) The CBK increased the CBR in small figures even after it knew that the situation was going to deteriorate greatly.
- (vi) The Bank received unscheduled visits from the regulator and received a letter from CBK regarding issues touching on the inter-bank exchange rate.
- (vii) The Bank was concerned as to why the governor of CBK could not predict the fluctuations in the interest rates.
- (viii) The bank will suffer due to the high volatility of the Shilling.

The Committee directed the bank to avail the following:-

- (i) Resubmit their presentation officially through the Clerk of the National Assembly within 72 hours.
- (ii) Correspondences received from the CBK and the responses they issued
- (iii) Forex held in the bank in the past 12 months and the profits realized by the banks in the last 3 quarters.

MIN. NO.48/2011 : ANY OTHER BUSINESS

There arose no other Business

MIN. NO.49/2011 : ADJOURNMENT AND DATE OF NEXT MEETING

The time being Twenty Minutes past Eleven O'clock the meeting was adjourned until Monday 19<sup>th</sup> December, 2011 at 10.00am.

SIGNED.....

  
(CHAIRMAN)

DATE.....

07/02/12

MINUTES OF THE 12<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON MONDAY, 19<sup>TH</sup> DECEMBER, 2011 IN THE CONFERENCE HALL COUNTY HALL MAIN PARLIAMENT BUILDINGS AT 2.30 P.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Abdul Bahari, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Yusuf Chanzu, M.P.

ABSENT WITH APOLOGY

The Hon. Peter Kiilu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Benjamin Langat, M.P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

IN ATTENDANCE

Mr. Ignatius Chicha  
Mr. David Abwoga  
Ms. MaryAnne Mwaura

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

CITI BANK

- Treasurer  
- Chief Financial Officer  
- Public Affairs Officer

MIN.NO.50/2011

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairperson informed the Citi Bank team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO.51/2011

: ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:

- (i) Meeting with Citi Bank
- (ii) Any Other Business
- (iii) Adjournment

MIN. NO.52/2011

: MEETING WITH CITI BANK

Citi Bank informed the Committee the following:-

- (i) The Shilling sharply declined in the months of October and November 2011 and this was due to the following:-
  - Inflation which was at 5% and the general public had a low inflationary expectation.
  - Forces of the market where there were no exports since the exporters were waiting for the prices of commodities to go up.
  - Forces of demand and supply.
- (ii) The bank trade within set parameters while following the rules and regulations in line with the core principles of the bank.
- (iii) Citi Bank was not able to judge if CBK's move was timely because they did not have the data which was the basis of the decisions that were taken at the time.
- (iv) The bank received two letters from the regulator who later made about three to four unscheduled visits to the bank which they called target inspection upon which the regulator requested for specific data and filed a report.

- (v) The bank did not access the inter-bank exchange window because their liquidity was good.
- (vi) The bank was concerned that the Regulator did not act in a timely manner.

The Committee directed the bank to avail the following:-

- (i) Resubmit their presentation to the Clerk of the National Assembly within 72 hours of the meeting.
- (ii) Copies of the letters issued by the CBK.
- (iii) A copy of the report that the CBK wrote.
- (iv) A report on the amount of Foreign exchange reserves held by the bank in the last 12 months.
- (v) Figures tabulating the profits made by the Bank in the last 3 quarters.

**MIN. NO.53/2011 : ADJOURNMENT AND DATE OF NEXT MEETING**

There being no other business and the time being Twenty Minutes past Five O'clock the meeting was adjourned by the Chairman.

SIGNED.....

  
(CHAIRMAN)

DATE.....

09/02/12

MINUTES OF THE 13<sup>th</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON WENESDAY, 25<sup>TH</sup> JANUARY, 2011 IN THE CONFERENCE HALL COUNTY HALL MAIN PARLIAMENT BUILDINGS AT 10.30 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Emilio Kathuri, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Peter Kiilu, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Yusuf Chanzu, M.P.

ABSENT WITH APOLOGY

The Hon. Martin Ogindo, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Shakila Abdalla, M.P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Dr. Gideon Muriuki  
Mr. Samuel Birech  
Mr. Charles Kamanda

CO-OPERATIVE BANK

- Group MD & C.E.O  
- Director Retail Banking  
- Treasurer

MIN. NO.54/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairman informed the Cooperative bank team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO.55/2011 :

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:-

- (i) Meeting with Co-op Bank
- (ii) Any Other Business
- (iii) Adjournment

MIN. NO.56/2011 :

MEETING WITH CO-OPERATIVE BANK

The bank informed the Committee the following:-

- (i) The bank has a total of thirteen directors who hold 4% shareholding in the bank; seven of the directors were elected by the cooperative holding society, two are elected by the ordinary share holders, one is the commissioner of cooperatives, one is the representative of the Permanent Secretary in charge of Treasury and one is the Managing Director of Cooperative Bank of Kenya.
- (ii) No officer was transferred or sacked during the period of June to December 2011
- (iii) The Kenya Cooperative Coffee Exporters Ltd is not owned by Cooperative bank.
- (iv) Some of the Kenya Cooperative Coffee Exporters Ltd's directors sit in the Cooperative Bank Board; however these directors are elected by farmers and not seconded by Cooperative Bank.

The Bank has seconded technical staff to the Kenya Cooperative Coffee Exporters Ltd to help put structures in place and help in the professional administration of the Company

- (v) The shareholding in the bank is as follows;
  - The Co-operative holding society has 65% of the total bank holding.



MINUTES OF THE 14<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON WEDNESDAY, 25<sup>TH</sup> JANUARY, 2011 IN THE CONFERENCE HALL COUNTY HALL MAIN PARLIAMENT BUILDINGS AT 10.00 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.

ABSENT WITH APOLOGY

The Hon. Adan Bare Duale, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Shakila Abdalla, M.P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Robert Nyaga  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Dr. Sambili Edward  
Mr. M. Isahakia  
Dr. Chris Kiptoo  
Mr. Mugo Kibati  
Mr. Gerald Nyaoma

TASKFORCE IN THE OFFICE OF THE PRIME MINISTER

- Permanent Secretary Ministry of Planning  
- Permanent Secretary OPM  
- Director Economic Policy Unit OPM  
- Director General Vision 2030 Service Delivery  
- Director Financial Market CBK

Mr. Habil Olaka - C.E.O Kenya Bankers Association  
Mr. Anthony Weru - Programme Officer KEPSA  
Mr. A.K.M Kilele - Kenya National Bureau of Standard

**MIN. NO.58/2011: PRELIMINARY**

The meeting started with a word of prayer. After introduction, the Chairman informed the Central bank team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

**MIN. NO.59/2011 : ADOPTION OF AGENDA**

The Agenda of the Sitting was adopted by the Members present as follows:

- (i) Meeting with Taskforce in the Office of the Prime Minister
- (ii) Any Other Business
- (iii) Adjournment

**MIN. NO.60/2011 : MEETING WITH THE TASKFORCE IN THE OFFICE OF THE PRIME MINISTER TO INVESTIGATE THE DECLINE OF THE KENYA SHILLING AGAINST FOREIGN CURRENCY**

- (i) Upon the presentation of the Taskforce report and deliberations the Committee noted the following:-
  - That the report was very scanty.
  - That the Taskforce report was a public relation exercise and had not addressed the real causes of the decline of the Kenya Shilling and what had triggered the crisis.
  - That this was yet another government activity to hoodwink the public.
- (ii) In its response the Taskforce explained as follows:-
  - Their main objective of the taskforce was to arrest the weakening of the Kenya Shilling.

- They did not capture the real causes of the decline.
- They sought for more time to interrogate the real causes of the decline of the Kenyan Shilling and report back to the Committee by Monday 30<sup>th</sup> January 2012 at midday.
- Its mandate was to create a forum where responsible actors in the crisis will dialogue.

(iii) The Committee advised the Taskforce to concentrate on the following among other things:-

- Whether multinational organizations outsourcing their services and staff from outside the country exerted pressure on the Shilling.
- what was the effect of ADB pronouncements that the Shilling would depreciate by 40% and the pronouncements made by the C.E.O Equity Bank the crisis will abate in 6months time.
- why some banks were suspended from the from the CBK overnight lending window.
- Why some officers in such banks were sacked.
- Whether inside trading occurred i.e. what was the relationship between C.E.Os of major bank with the CBK.
- How many banks used the current account window at 2% and where did the money go; and whether the money was used for speculation in the forex exchange markets between October to November 2011.

MIN. NO.61/2011 : ANY OTHER BUSINESS

- (i) **Involvement of an expert in the report writing**  
The Committee resolved to involve an expert during its report writing stage for ease of interpretation of the findings.

MIN. NO.62/2011 : ADJOURNMENT AND DATE OF NEXT MEETING

There being no other business and the time being Elleven O'clock the meeting was adjourned by the Chairman.

SIGNED.....  
(CHAIRMAN)

DATE..... 07/02/12

MINUTES OF THE 15<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON WEDNESDAY, 25<sup>TH</sup> JANUARY, 2012 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 11.30 A.M.

PRESENT

The Hon. Adan Keynan, M.P.	- Chairperson
The Hon. Rachel Shebesh, M.P.	- Vice Chairperson
The Hon. Peter Kiilu, M.P.	
The Hon. Yusuf Chanzu, M.P.	
The Hon. Martin Ogindo, M.P.	

ABSENT WITH APOLOGY

The Hon. Benjamin Langat, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Benjamin Ng'imor  
Ms. Farida Ngasura  
Mr. Simon Muinde

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Dr. Oburu Oginga  
Dr. Geoffrey Mwau  
Mr. Henry Rotich

MINISTRY OF FINANCE

- Assistant Minister for Finance  
- Economic Secretary  
- Deputy Director Economic Secretary

MIN. NO.63/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairman informed the team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO.64/2011:

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:

- (i) Meeting with the Treasury
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

MIN. NO.65/2011:

SUBMISSION BY THE TREASURY

Treasury informed the Committee the following:-

**Causes of depreciation of the Kenya Shilling.**

- (i) The issues behind the decline of the Kenya Shilling were two pronged: Internal and External factors. The external factors were given as the rise in the price of crude oil in the International market, the importation of food due to drought and the crisis in the Middle East. The internal factors include drought which led to the importation of food from the International market, infrastructural and energy sector development due to the importation of machinery and building materials, shortage of power which led to the government resorting to high cost energy. The above factors led to the expansion of credit which stood at 36% by October 2011.
- (ii) Due to the common tariff agreement within the East African Community, treasury could not do without going back to the community to request the same, something which takes long to achieve since there is a long procedure to follow.
- (iii) When asked to respond to the statements attributed to the CBK governor to the effect that "...Kenya is a free market, and the market will stabilize itself..." and that "...some banks are holding forex for speculation purposes..", the minister said he could not respond to the statements since they were only in the media and not official statements.

- (iv) Some banks were using the window period to make some money which is not illegal.

#### Interventions

- (i) Treasury issued a circular to other departments of government to minimize government expenditure on non-essential items.
- (ii) Treasury intended to limit internal borrowing and instead borrow from outside which is cheaper and could help stabilize the Shilling.
- (iii) CBK lowered exposure to foreign exchange from 20% to 10%
- (iv) IMF approved the government's request to lend the government USD 700 million.

#### Committee observations

- (i) The importation of non-essential goods was still happening and the government was not doing something about it like introducing higher tariffs.
- (ii) Some multinational banks were still seeking services for example card services for banks from outside the country hence putting more pressure on the dollar.

#### More Information

The Committee was not satisfied with the responses from Treasury and directed them to submit the following documents to the committee:-


- Minutes and correspondences between the CBK and treasury during that period.
- Report on how much money was borrowed from the domestic market.
- Report on interest rates payable, and after what period for the last four months.

MIN. NO.66/2011:

ADJOURNMENT

There being no other business and the time being Thirty Minutes past One O'clock, the meeting was adjourned.

SIGNED.....

  
(CHAIRMAN)

DATE.....

09/02/12

MINUTES OF THE 16<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELEECT COMMITTEE ON  
THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON  
WEDNESDAY, 25<sup>TH</sup> JANUARY, 2012 IN THE MAIN CONFERENCE ROOM, COUNTY  
HALL AT 2.30 P.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Emilio Kathuri, M.P.

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.

IN ATTENDANCE

Mr. James Ginono  
Mr. George Otieno  
Mr. Robert Nyaga  
Mr. Benjamin Ng'imor  
Ms. Farida Ngasura  
Mr. Simon Muinde

IN ATTENDANCE

Mr. Peter Munyiri  
Mr. David Thuo  
Ms. Kanini Kioko

NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

FAMILY BANK

- Chief Executive Officer  
- Treasury Advisor  
- Treasurer

MIN. NO.67/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairman informed the Family Bank team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

MIN. NO.68/2011:

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows;

- (i) Meeting with Family Bank
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

MIN. NO.69/2011:

SUBMISSION BY FAMILY BANK

Family Bank informed the Committee the following:-

- (i) The core problem is inflation as a result of importation of food and non-essential goods. This has been brought about by structural weaknesses and fundamentals around the Kenyan economy.
- (ii) The following factors should be addressed to curb this issue:-
  - **Food supply issues:** Food production for most of the country was suppressed due to inadequate rainfall. This resulted in the prices of food commodities rising hence a rise in inflation. Importation of food also worsened the balance of payments and weakening of the Shilling. The Country needs to create food security at local level
  - **Fuel Demand:** The demand for fuel went up due to inadequate rainfall that occasioned a shift from the traditional hydro generation of electricity to thermal generation of electricity. The cost of fuel thus contributed significantly to the growth in inflation and the depreciation of the Kenya Shilling.
  - **Interest rate changes:** The cost of borrowing went up and the producers passed this burden to the final consumer. There is need to have the right balance between interest rates and exchange rates

Family Bank recommended as follows:-

- (i) **CBK monetary policy:** A tight monetary policy should be maintained until the country achieves the right balance on interest rates and exchange rates. However, it is noted that it takes between one and two years for actions of Central Banks to transmit full impact into the economy.
- (ii) **Food security:** Kenya relies heavily on the rainfall fed agriculture which results in less than adequate food production. There is therefore need to develop agricultural policies that encourage irrigation agriculture and improve or move away from traditional forms of agriculture
- (iii) **Energy generation:** There is need to move from over reliance on hydro generation of electricity to other forms of electricity such as thermal and wind
- (iv) **Debt and Growth:** A clear plan on how to lower the debt into the future should be developed.

MIN. NO.70/2011:                      ADJOURNMENT

There being no other business and the time being Four O'clock the meeting was adjourned.

SIGNED.....  
(CHAIRMAN)

DATE.....09/02/12.....

MINUTES OF THE 17<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON MONDAY, 30<sup>TH</sup> JANUARY, 2012 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 11.30 A.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Charles Kilonzo, M.P.

ABSENT WITH APOLOGY

The Hon. Abdul Bahari, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Emilio Kathuri, M. P.

IN ATTENDANCE

Mr. George Otieno  
Ms. Caroline Kinyua  
Mr. James Ginono  
Mr. Michael Karuru  
Mr. Robert Nyaga  
Mr. Benjamin Ng'imor  
Ms. Farida Ngasura  
Mr. Somin Muinde

KENYA NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Clerk Assistant  
- Legal Counsel  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Mr. Peter Gatere  
Mr. Gerald Nyaoma

CENTRAL BANK OF KENYA

- Assistant Director CBK  
- Director Financial Markets

Mr. Gabriel S. Mbuvi

- Director B.F.I.D

**MIN. NO.71/2011:**

**PRELIMINARY**

The meeting started with a word of prayer. After introduction, the Chairman informed the Central bank team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

**MIN. NO.72/2011:**

**ADOPTION OF AGENDA**

The Agenda of the Sitting was adopted by the Members present as follows:-

- (i) Meeting with Central Bank
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

**MIN.NO.73/2011**

**MEETING WITH THE GOVERNOR CENTRAL**

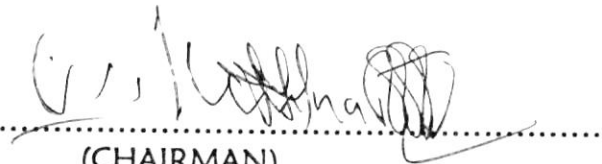
- (i) The Committee was informed by the representative of the Governor that the Governor was held up in another function and therefore could not appear before it.
- (ii) The Committee noted that the Governor had earlier appeared before it and the Members wanted to interrogate him further on some of the issues that arose in that earlier meeting.
- (iii) The Committee consequently resolved not to entertain the representatives of the Governor but to summon him personally to appear before the Committee the following day Tuesday, 31<sup>st</sup> January 2012 to address the following issues:-
  - 1) Report on overnight lending facility for Central Bank of Kenya for the last 24 months.
  - 2) The central Bank of Kenya balance sheet for the last 24 months.
  - 3) Periodic inspection reports of the Banks allegedly involved in these malpractices.

- 4) List of the top 50 importers and top 50 exporters and volumes of Dollars they transact.
- 5) Any report of the volumes of Dollars traded by different forex bureaus for the last 24 months.
- 6) Investigation report on individual banks that the governor was quoted to have suspected to be hoarding foreign currencies, or abused the discount window and any other malpractices.
- 7) Any suspension of specific financial institutions from participating in the interbank market or foreign exchange market.
- 8) Any knowledge of insider dealing by Chief Executive Officers of various banks.
- 9) Any other regulatory intervention by the Central Bank of Kenya regarding the sudden fall of the Kenya Shilling.

MIN. NO.74/2011 : ADJOURNMENT

There being no other business and the time being 12.00 noon, the meeting was adjourned.

SIGNED.....

  
(CHAIRMAN)

DATE.....

09/02/12

MINUTES OF THE 18<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON MONDAY, 30<sup>TH</sup> JANUARY, 2012 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 2.40 P.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Emilio Kathuri, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Chris Okemo, M. P.

ABSENT WITH APOLOGY

The Hon. Abdul Bahari, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.

IN ATTENDANCE

Mr. George Otieno  
Ms. Caroline Kinyua  
Mr. Michael Karuru  
Mr. Robert Nyaga  
Mr. Benjamin Ng'imor  
Ms. Farida Ngasura  
Mr. Simon Muinde

IN ATTENDANCE

Dr. James Mwangi  
Mr. Moris Sioi  
Mr. Daniel Odongo

KENYA NATIONAL ASSEMBLY

- Clerk Assistant  
- Clerk Assistant  
- Legal Counsel  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

EQUITY BANK

- CEO Equity Bank

Mrs. Mary Wamae  
Mrs. Catherine Maina  
Mr. Robert Otieno

MIN. NO.75/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairperson informed the team from Equity Bank that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

The Chairman reminded the Director of the need to tell the truth in accordance with Article 125 of the Constitution, '*(1) Either House of Parliament, and any of its Committees, has the power to summon any person to appear before it for the purpose of giving evidence or providing information.*

*(2) For the purpose of clause (1), a House of Parliament or any of its Committees has the same powers as the court-*

*(a) to enforce the attendance of a witness and examine them under oath, affirmation or otherwise;*

*(b) to compel the production of documents; and*

*(c) to issue a commission or request to examine witness abroad'.*

MIN. NO.76/2011:

ADOPTION OF AGENDA

The Agenda of the Sitting was adopted by the Members present as follows:

- (i) Meeting with Equity Bank
- (ii) Any Other Business
- (iii) Adjournment and date of the next meeting

MIN. NO.77/2011:

PRESENTATION BY EQUITY BANK OF KENYA

The Chief Executive Officer Equity Bank informed the Committee the following:-

- (i) Equity Bank did not receive any warning letters regarding the bank's foreign exchange trading activities, the use of the discount window for the Central Bank of Kenya, and participation in the interbank lending market.
- (ii) Equity Bank was not suspended from participating in foreign exchange markets, use of the discount window of the Central Bank of Kenya, and participation in the interbank lending market.
- (iii) Equity Bank did not receive any ad hoc visits from the Central Bank of Kenya regarding the bank's foreign exchange trading activities, the use of the discount window of the Central Bank of Kenya, and participation in the interbank lending.
- (iv) No single client in Equity Bank was doing back to back borrowing.
- (v) The Chief Executive Officer of Equity Bank did not at any time participate in Policy formulation at the Central Bank as his bank is not among the top dealers in foreign currency.
- (vi) Equity Bank did not participate in buying any foreign currency but had given loans to Kenya Power and Lighting Company – 70 million dollars, RVR – 20 million dollars and African Gas 40 million dollars.
- (vii) Equity Bank's holding in Foreign Exchange reserves averaged 0.02 months of Kenya's import cover, compared with 3.45 months of the whole country import cover, an amount too insignificant to affect the foreign exchange market in any way.
- (viii) The forex holdings reflect the foreign currency loans that the bank has taken from International Development Institutions e.g. Responsibility Fund, Microfinance Enhancement Facility (MEF) and China Development Bank.
- (ix) There were no unusual transactions or volumes done by the bank's clients due to the bank's stringent process of credit evaluation and transaction monitoring.
- (x) The forex denominated loans sourced from these international development institutions eased the pressure on the Kenya Shilling as borrowers did not have to buy foreign currency from the market i.e. the loans were supportive of a stronger Kenya Shilling.
- (xi) Equity Bank is ranked 9<sup>th</sup> out of 43 banks in terms of foreign exchange holdings (as at end of Quarter 3, 2011), demonstrating that it is indeed a small player in the forex market. The bank earned Kenya Shillings 508 million, significantly below the top 4 ranked banks whose forex income ranged from Kenya Shillings 1.298 billion to 2.093 billion.
- (xii) While the bank is ranked among the top 3 biggest banks in terms of total assets, profits, total operating income, customer base and shareholders' funds, its rank in terms of foreign exchange income significantly lags all other parameters. This reflects its core business of banking the microfinance sector.
- (xiii) The Net foreign exchange exposure (i.e. the aggregate between the open short and long forex exposure) was always within policy stipulations and was supportive of the Kenya Shilling.
- (xiv) Equity Bank's forex income is less than 3% of its total profit before tax, compared to other banks that recorded forex income numbers ranging from 10% to 30% of their profit before tax. This reflects the nature of the bank's clients, few of whom are actively engaged in international activities.

**Committee Observations**

- (i) The Committee was concerned that the Equity Bank CEO apparently had insider information that the Shilling would gain against other currencies within six months. This statement was attributed to him during the period that the Shilling was depreciating faster. The CEO however, informed that committee that he was relying on other sources such as the World Bank and other economic institutions whose published research articles are publicly available. These institutions have regularly published, and continue to regularly publish, their research material on their official websites and these are widely reported in the media.
- (ii) The Committee was also concerned that there were allegations within the sector that the CEO of Equity Bank was having a lot of influence on the CBK governor hence the Bank was getting favours from CBK. The CEO on his part denied the allegations and termed them malicious as neither him nor the bank did at any time participate in Policy formulation at the Central Bank.

The CEO reiterated that he and the bank are totally clean on the matter under investigation and challenged anyone with any information to the contrary to provide it to prove otherwise.

MIN. NO.78/2011 : ADJOURNMENT

There being no other business and the time being Thirty Minutes past One O'clock, the meeting was adjourned.

SIGNED.....  
  
(CHAIRMAN)

DATE..... 09/02/12 .....

- (viii) The use of foreign exchange reserves to protect the Shilling was not feasible. Uganda, Tanzania and Nigeria all tried this route and drained the reserves without strengthening their currencies.
- (ix) Exports were only financing 51 % of imports, so foreign exchange inflows were not matching outflows, trade deficit was growing at an alarming rate.
- (x) Fuel and food imports (sugar became significant) putting pressure on the exchange rate while at the same time causing inflation to rise.
- (xi) Central Bank applied various measures to stabilize the exchange rate and lower inflation:
  - Issued guidelines to limit foreign exchange trading in swaps derivatives
  - Tightened monetary policy to fight inflation and its expectations. This raised interest rates and shifted the commercial banks portfolios out of foreign exchange assets to Kenya Shilling assets. This led to decline for credit to financial reports.
- (xii) Various financial players including banks, were involved in arbitrage (borrowing from Central Bank through the Discount Window) and using those funds for foreign exchange trading to buy government securities.

Central Bank issued guidelines to curtail the capacity of banks to use funds borrowed from the Central Bank discount Window for speculation:-

There were limits to the frequency and amounts that could be taken from the Discount Window

Operations in the interbank and foreign exchange dealings were checked prior to any access to the window

- (xiii) Central Bank took regulatory action and visits to various financial institutions regarding the sudden depreciation of the Shilling in 2011. The visits were associated with regular audits and were conducted on all banks involved in foreign exchange dealings.

The visits established that banks had foreign exchange currency dominant in their balance sheets and that commercial banks demand for US Dollars to meet higher costs of oil and food imports were causing speculation on the price of the dollars.

- (xiv) Following guidelines to provide a letter from CBK to commercial banks dated 13<sup>th</sup> October, 2011 with respect to the tenor of swaps, one bank infringed these guidelines and was suspended from participation in the swap market for 30 days

and penalized Kshs1 million in line with the Banking Act – (Section 2 (a) of Legislation No. 77 of 1999).

- (xv) From the survey results that indicated significant foreign exchange trading derivatives in the market, the following measures were undertaken:-
- Convened a Special Monetary Policy Committee to explicitly deal with the weakening Shilling which resolved to have monthly meetings.
  - Suspended the use of Electronic Brokerage System by banks due to lack of full disclosure.
  - Limited the tenor of swaps and Shilling borrowing where offshore banks are involved to a tenor of not less than one year.
  - Limited the tenor of swaps between residents to a tenor of not less than seven days.
  - Reduced the foreign exchange exposure ration from 20 percent to 10%.
  - Required local banks to obtain supporting documents for all transactions in the Nostro accounts of the off shore banks.
- (xvi) Monetary Policy Committee meetings were held on a monthly basis when the fall of the Shilling started.
- (xvii) Central Bank had anticipated that the inflation will affect the Shilling, due to the increasing fuel price and the situation in Europe and Middle East and also due to the sugar shortage.
- (xviii) The Governor of Central Bank was appointed through a letter and did not undergo any interviews.
- (xix) Central Bank formulates monthly monetary policies which are sent to Parliament.
- (xx) The Central Bank conformed to its mandate but could not anticipate some flash shocks like the fuel prices.
- (xxi) The country had similar shocks in the year 1979 and 1991.
- (xxii) The Monetary Policy Committee has four internal members, four external members and one ex official from treasury. The Monetary Policy Committee makes decisions that are binding but not individual decisions.
- (xxiii) Central Bank is building their strength to ensure that Kenya is not hit by the Euro crisis but exporters of such items such coffee, flowers and tea will still be affected.

*The Session went in Camera*

The session went into camera in order to allow the Governor to disclose the names of the banks that got explanatory/clarification letters and the one that was suspended for infringing guidelines on tenor swaps.

The Governor upon getting leading questions from the Committee informed the Committee the following:

- (i) Following guidelines issued with respect to the tenor of swaps, CFC Stanbic Bank (K) Ltd infringed those guidelines and was suspended from participation in the swap market for 30 days and penalized Kshs1 million in line with the Banking Act – (Section 2 (a) of Legislation No. 77 of 1999).
- (ii) The three banks that were given clarification/explanation letters by Central Bank were CFC Stanbic Bank (K) Ltd, the Standard Chartered Bank (K) Ltd and Citibank N.A. Kenya.

MIN. NO.82/2011: ADDITIONAL INFORMATION

The Committee directed the Governor to avail the following by Wednesday 1, February 2012:-

- (i) Minutes of the Monetary Policy Committee meetings
- (ii) Monthly Monetary Policy Statements
- (iii) Copies of letters sent to the banks requesting for clarification

MIN. NO.83/2011: ADJOURNMENT

There being no other business and the time being Seven O'clock the meeting was adjourned.

SIGNED.....  
(CHAIRMAN)

DATE.....09/02/12.....

MINUTES OF THE 20<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON THURSDAY, 2<sup>ND</sup> FEBRUARY 2012 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 2.30 P.M.

PRESENT

The Hon. Adan Keynan, M.P.	- Chairperson
The Hon. Rachel Shebesh, M.P.	- Vice Chairperson
The Hon. Peter Kiilu, M.P.	
The Hon. Yusuf Chanzu, M.P.	
The Hon. Benjamin Langat, M.P.	
The Hon. Moses Lesonet, M.P.	
The Hon. Adan Bare Duale, M.P.	
The Hon. Abdul Bahari, M.P.	

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Emilio Kathuri, M.P.

IN ATTENDANCE

KENYA NATIONAL ASSEMBLY

Mr. Boniface Mathooko	- Senior Researcher
Mr. George Otieno	- Clerk Assistant
Ms. Caroline Kinyua	- Clerk Assistant
Mr. Michael Karuru	- Legal Counsel
Mr. Robert Nyaga	- Fiscal Analyst
Mr. Benjamin Ng'imor	- Fiscal Analyst
Ms. Farida Ngasura	- Hansard Recorder
Mr. Simon Muinde	- Hansard Recorder

MIN. NO.84/2011:

PRELIMINARY

The meeting started with a word of prayer. After introduction, the Chairman informed the National Security Intelligence Service team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and



There being no other business and the time being Forty Minutes past Three O'clock, the Chairman adjourned the meeting until Monday 06, February 2012 at 10.00 a.m.

SIGNED.....  
(CHAIRMAN)

DATE.....  
09/02/12

MINUTES OF THE 21<sup>ST</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON MONDAY, 6<sup>TH</sup> FEBRUARY 2012 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 10.30 A.M.

PRESENT

The Hon. Adan Keynan, M.P.	- Chairperson
The Hon. Rachel Shebesh, M.P.	- Vice Chairperson
The Hon. Peter Kiilu, M.P.	
The Hon. Yusuf Chanzu, M.P.	
The Hon. Benjamin Langat, M.P.	
The Hon. Adan Bare Duale, M.P.	
The Hon. Jakoyo Midiwo, M.P.	
The Hon. Martin Ogindo, M.P.	

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Moses Lesonet, M.P.  
The Hon. Abdul Bahari, M.P

IN ATTENDANCE

Mr. Boniface Mathooko  
Mr. George Otieno  
Ms. Caroline Kinyua  
Mr. Michael Karuru  
Mr. Robert Nyaga  
Mr. Benjamin Ng'imor  
Ms. Farida Ngasura  
Mr. Simon Muinde

KENYA NATIONAL ASSEMBLY

- Senior Researcher  
- Clerk Assistant  
- Clerk Assistant  
- Legal Counsel  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder  
- Hansard Recorder

IN ATTENDANCE

Mr. Richard Etemesi  
Mr. Saloum Jobartch  
Mr. Munir Ahmed

STANDARD CHARTERED BANK

- Standard Chartered Bank Chief Executive Officer  
- Standard Chartered Bank Head of Global Markets  
- Standard Chartered Bank Head of Compliance

**MIN. NO.89/2011:**

**PRELIMINARY**

The meeting started with a word of prayer. After introduction, the Chairman informed the Standard Chartered Bank team that the select Committee was established through a resolution of the House with the mandate of investigating and inquiring into the causes of drastic and sharp decline of the Kenya Shilling against foreign currencies and to make recommendations on the way forward. This he said was necessitated by the fact that Kenya was facing a spike in inflation and her currency had plummeted to its weakest level and was now recorded as the continent's worst performer last year despite being fairly stable for the last four decades. There was also further concern that the Central Bank of Kenya had maintained a "wait and see attitude" and had publicly admitted that it could not control the currency slip citing that some commercial banks were hoarding foreign currencies. As a result, the depreciation trend had made many Kenyans and foreign investors incur massive losses and the cost of transacting business became unduly expensive.

The Chairperson informed the Chief Executive Officer of Standard Chartered Bank that he had been summoned because he did not honour two prior invitations that were extended to him by the Committee and that for that reason he would give his evidence under the oath.

**MIN. NO.90/2011:**

**PRESENTATION BY STANDARD CHARTERED BANK**

The Chief Executive Officer of Standard Chartered Bank informed the Committee the following:-

- (i) Standard Chartered Bank was appearing before a Parliamentary Committee for the first time.
- (ii) Standard Chartered Bank did not receive any warning, clarification or explanation letters regarding the bank's foreign exchange trading activities, the use of the discount window for the Central Bank of Kenya, and participation in the interbank lending market.
- (iii) The Bank was never suspended from participating in foreign exchange markets, use of the discount window of the Central Bank of Kenya, and participation in the interbank lending market
- (iv) The Bank did not borrow from the discount window provided by Central Bank over the period when the Shilling had fallen as they relied on own funds and deposits from clients.

The Bank's internal policy is that they are only allowed to borrow from the discount window as a last resort. In year 2011, the bank borrowed from the discount window only twice.

- (v) Central Bank visits the Standard Chartered Bank from time to time and they are allowed to do so under the Central Bank Act. It is presumed that the visits are regular and normal.
- (vi) The depreciation of the Shilling was caused by:
- Lack of clear policy direction between the three key players in the banking sector; the Central Bank, the Treasury and the Kenya Bankers Association.
  - Increase in interests rates which caused a shrinkage for demand in Shilling
- (vii) Standard Chartered Bank is one of the best performing banks worldwide.
- (viii) The Chief Executive Officer did not understand why Standard Bank name kept on coming up as one of the banks that were involved in foreign exchange irregularities as there is no evidence to show that the bank was involved in any malpractices.
- (ix) At the time when the Shilling depreciated, the Central Bank interest rate was between 3% - 4%. Inflation continued to rise while the interest rates remained low so the solution was to raise the interest rate to address the issue of inflation.
- (x) The bank raised their lending rates in direct response to Central Bank's raised interests rates.
- (xi) The Bank sold more dollars than they bought during the period when the Shilling was down and people were saving in dollars as opposed to Shillings.
- (xii) Standard Chartered Bank is among the 3rd, 4th, 5th largest bank in Kenya and that explains why it was among the top five banks in total foreign assets.
- (xiii) The bank does not hold foreign currencies as its own but holds on behalf of it's clients. During the period when the Shilling was down the bank did not trade using the dollars held for customers. The bank is not supposed to hold more than 15 million dollars.
- (xiv) The bank does not have a liquidity problem.
- (xv) During the period when the Shilling declined the Central Bank of Kenya called for meetings between the Chief Executive Officers of the banks and the Kenya Bankers Association to discuss the causes of the inflation and its solutions to the problem. The inflation was a demand driven problem and recommendations for interest rates to be increased were given.
- (xvi) Kenya Bankers Association is a lobby group that comes together to address issues affecting all banks but this does not hinder competition among the banks as each bank has its own internal policies.
- (xvii) The Kenya Bankers Association membership comprises of the chief executive officers from twelve banks among them the Kenya Commercial Bank, Standard Chartered Bank, Barclays Bank, NIC Bank, Diamond Trust Bank, I&M Bank, Co-operative Bank, Guardian Bank, UBA Bank and Commercial Bank of Africa.
- (xviii) The Bank did not sell treasury bills in order to buy dollars during the period when the Shilling was down.

- (xix) Kenya for a long time has been living beyond its means as the credits were affordable and individual borrowing exceeded corporate borrowing as individuals borrowed to buy cars and finance homes and holidays.
- (xx) There is no sweet pill to fix the problem of the high interest rates, it is however expected that the inflation rates will likely come down by end of the first quarter of the year.
- (xxi) The base rate for lending by various banks and finance institutions are determined by the bank's liquidity and the risk profiling of the banks.
- (xxii) Over the last four years the Central bank of Kenya performed well in its regulatory role in comparison to the macroeconomic situation worldwide.
- (xxiii) If the proposed amendments on the banking sector, currently with the Central bank of Kenya goes through then the banking environment will be strengthened.

**MIN. NO.90/2011:**

**ADDITIONAL INFORMATION**

The Committee directed the Chief Executive Officer of the Standard Chartered Bank to avail the following information to the Committee by Tuesday 7<sup>th</sup> February 2012.

- Foreign exchange holding record on a daily basis from July to December 2011.
- Record of borrowing from the discount window from July to December 2011.
- A copy of the proposed amendments to the Banking Act

**MIN. NO.91/2011:**

**ANY OTHER BUSINESS**

**(i) Meeting with National Security Intelligence Service**

The Committee was informed that the meeting with the National Security Intelligence Service would not take place as they had written a letter indicating that they would not attend the meeting and also seeking the direction of the Committee to deliberate on what had been put together by the Committee in relation to the information that they had.

The Committee was of the view that it was unfortunate that it would compile its report without the input of the National Security Intelligence Service since the evidence taking had come to a closure.

**(ii) Appreciation to the Members of the Fourth Estate**

The Chairman thanked the Members of the Fourth Estate and informed them that the meeting marked the end of the interaction with them and the Committee.

**(iii) Report Writing**

The Chairperson informed the Committee that an approval had been given for Members to retreat for report writing in Mombasa as opposed to Naivasha as had earlier been communicated. The retreat will take place either at Continental Hotel or the Serena Hotel.

The Chairperson informed the Members of the importance to have all Members confirm their attendance for the retreat. He further informed Members that in order to adopt the report more than thirteen Members must be present.

The Committee directed the secretariat to ensure that all the documentation that had been presented by various organizations during the evidence taking is availed and in addition provide copies of the Central Bank of Kenya Prudential Guidelines and the Central Bank of Kenya Act.

**(iv) Confirmation of Minutes**

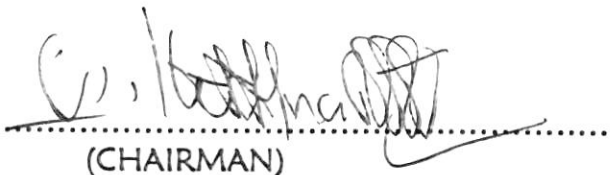
The Committee resolved to confirm the minutes and to peruse through the draft report on Tuesday 7<sup>th</sup> February 2012.

MIN. NO.92/2011:

ADJOURNMENT

There being no other business and the time being Forty Minutes past Twelve O'clock, the Chairman adjourned the meeting until Tuesday 7<sup>th</sup> February 2012.

SIGNED.....

  
(CHAIRMAN)

DATE.....

09/02/12

MINUTES OF THE 22<sup>ND</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON TUESDAY, 7<sup>TH</sup> FEBRUARY 2012 IN THE MAIN CONFERENCE ROOM, COUNTY HALL AT 2.30 P.M.

PRESENT

The Hon. Adan Keynan, M.P.	- Chairperson
The Hon. Rachel Shebesh, M.P.	- Vice Chairperson
The Hon. Peter Kiilu, M.P.	
The Hon. Moses Lesonet, M.P.	
The Hon. Ntoitha M'Mithiaru, M.P.	
The Hon. (Dr.) Erastus Mureithi, M.P.	
The Hon. Martin Ogindo, M.P.	
The Hon. Benjamin Langat, M.P.	
The Hon. Adan Bare Duale, M.P.	
The Hon. Jakoyo Midiwo, M.P.	

ABSENT WITH APOLOGY

The Hon. Yusuf Chanzu, M.P.  
The Hon. Charles Kilonzo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Emilio Kathuri, M. P.

IN ATTENDANCE

Mr. Boniface Mathooko  
Mr. George Otieno  
Ms. Caroline Kinyua  
Mr. Michael Karuru  
Mr. Robert Nyaga  
Mr. Benjamin Ng'imor  
Mr. Simon Muinde

KENYA NATIONAL ASSEMBLY

- Senior Researcher  
- Clerk Assistant  
- Clerk Assistant  
- Legal Counsel  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder

MIN. NO.93/2011:

PRELIMINARY

The meeting started with a word of prayer. The Chairperson informed the Members that they should confirm attendance to the Report Writing Retreat at a venue to be confirmed in Mombasa. He underscored the need to have an absolute majority for the

adoption of the Committee report and urged all Members to avail themselves to attend the retreat.

MIN. NO.94/2011:

CONFIRMATION OF MINUTES

The following minutes were confirmed:-

- (i) The Minutes of the 1<sup>st</sup> sitting held on 18<sup>th</sup> November, 2011 at 10.00 am were proposed by the Hon. Martin Ogindo, M. P. and seconded by the Hon. Moses Lessonet, M. P.
- (ii) The Minutes of the 2<sup>nd</sup> sitting held on 24<sup>th</sup> November, 2011 at 10.00 am were proposed by the Hon. (Dr.) Erastus Mureithi, M.P. and seconded by the Hon. Peter Kiilu, M.P.
- (iii) The Minutes of the 3<sup>rd</sup> sitting held on 25<sup>th</sup> November, 2011 at 10.00 am were proposed by the Hon. Peter Kiilu, M.P. and seconded by the Hon. Rachel Shebesh, M.P.
- (iv) The Minutes of the 4<sup>th</sup> sitting held on 28<sup>th</sup> November, 2011 at 10.00 am were proposed by the Hon. Benjamin Langat, M.P. and seconded by the Hon. (Dr.) Erastus Mureithi, M.P. with amendments by deleting the words "stock index report" and replacing with the words "volumes of trade"
- (v) The Minutes of the 5<sup>th</sup> sitting held on 1<sup>st</sup> December, 2011 at 10.00 am were proposed by the Hon. Moses Lessonet, M.P. and seconded by the Hon. (Dr.) Erastus Mureithi, M.P. with amendments by deleting the words "Capital Markets Authority" and replacing with the words "experts above"
- (vi) The Minutes of the 6<sup>th</sup> sitting held on 6<sup>th</sup> December, 2011 at 10.00 am were proposed by the Hon. Martin Ogindo, M.P. and seconded by the Hon. Peter Kiilu, M.P. with amendments by deleting the words "Chairman" immediately after Mr. Micah Cheserem and replacing with the words "Former Governor, Central Bank of Kenya"
- (vii) The Minutes of the 7<sup>th</sup> sitting held on 8<sup>th</sup> December, 2011 at 11.15 am were proposed by the Hon. Martin Ogindo, M.P. and seconded by the Hon. Peter Kiilu, M.P.
- (viii) The Minutes of the 8<sup>th</sup> sitting held on 13<sup>th</sup> December, 2011 at 10.00 am were proposed by the Hon. (Dr.) Erastus Mureithi, M.P. and seconded by the Hon. Martin Ogindo, M.P.
- (ix) The Minutes of the 9<sup>th</sup> sitting held on 14<sup>th</sup> December, 2011 at 10.00 am were proposed by the Hon. Benjamin Langat, M.P. and seconded by the Hon. Peter Kiilu, M.P.
- (x) The Minutes of the 10<sup>th</sup> sitting held on 15<sup>th</sup> December, 2011 at 10.00 am were proposed by the Hon. Martin Ogindo, M.P. and seconded by the Hon. (Dr.) Erastus Mureithi, M.P.
- (xi) The Minutes of the 11<sup>th</sup> sitting held on 16<sup>th</sup> December, 2011 at 10.00 am were proposed by the Hon. Benjamin Langat, M.P. and seconded by the Hon. Martin Ogindo, M.P.

- (xii) The Minutes of the 13<sup>th</sup> sitting held on 25<sup>th</sup> January, 2012 at 10.30 am were proposed by the Hon. Peter Kiilu, M.P. and seconded by the Hon. Moses Lesonnet, M.P. with amendment by deleting the words "June and May" and replacing with the words "May and June 2011"
- (xiii) The Minutes of the 14<sup>th</sup> sitting held on 25<sup>th</sup> January, 2012 at 10.00 am were proposed by the Hon. (Dr.) Erastus Mureithi, M.P. and seconded by the Hon. Martin Ogindo, M.P.

MIN. NO.95/2011:

ADJOURNMENT

There being no other business and the time being Forty Minutes past Three O'clock, the Chairman adjourned the meeting.

SIGNED.....

  
(CHAIRMAN)

DATE.....

10/02/12

MINUTES OF THE 23<sup>RD</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON THURSDAY, 9<sup>TH</sup> FEBRUARY 2012 AT SEVERIN SEA LODGE, MOMBASA AT 9.30 A.M.

PRESENT

The Hon. Adan Keynan, M.P.	- Chairperson
The Hon. Rachel Shebesh, M.P.	- Vice Chairperson
The Hon. Peter Kiilu, M.P.	
The Hon. Ntoitha M'Mithiaru, M.P.	
The Hon. (Dr.) Erastus Mureithi, M.P.	
The Hon. Martin Ogindo, M.P.	
The Hon. Benjamin Langat, M.P.	
The Hon. Adan Bare Duale, M.P.	
The Hon. Jakoyo Midiwo, M.P.	
The Hon. Yusuf Chanzu, M.P.	
The Hon. Emilio Kathuri, M. P.	
The Hon. Moses Lesonet, M.P	

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.
The Hon. (Prof.) Philip Kaloki, M. P.
The Hon. Benedict Gunda, M.P.
The Hon. Shakila Abdalla, M.P.
The Hon. Chris Okemo, M. P.
The Hon. Shakeel Shabbir, M.P.
The Hon. Abdul Bahari, M.P.

IN ATTENDANCE

KENYA NATIONAL ASSEMBLY

Mr. Boniface Mathooko	- Senior Researcher
Mr. George Otieno	- Clerk Assistant
Ms. Caroline Kinyua	- Clerk Assistant
Mr. Michael Karuru	- Legal Counsel
Mr. Robert Nyaga	- Fiscal Analyst
Mr. Benjamin Ng'imor	- Fiscal Analyst
Mr. Simon Muinde	- Hansard Recorder

MIN. NO.96/2011:

PRELIMINARY

The meeting started with a word of the Chairperson welcomed the Members to the Report Writing Retreat. He thanked the Members for availing themselves to attend the retreat. He further informed the Members that expectations from all stakeholders were

very high however, he was very positive that the Committee would come up with a very good report.

**MIN. NO.97/2011:**

**CONFIRMATION OF MINUTES**

- (i) The Minutes of the 15<sup>th</sup> sitting held on 25th January, 2012 at 11.30 am were proposed by the Hon. Rachel Shebesh, M.P. and seconded by the Hon. Yusuf Chanzu, M.P.
- (ii) The Minutes of the 16<sup>th</sup> sitting held on 25th January, 2012 at 2.30 pm were proposed by the Hon. (Dr.) Erastus Mureithi, M.P. and seconded by the Hon. Peter Kiilu, M.P.
- (iii) The Minutes of the 17<sup>th</sup> sitting held on 30th January, 2012 at 11.30 am were proposed by the Hon. Martin Ogindo, M.P. and seconded by the Hon. Adan Duale, M.P.
- (iv) The Minutes of the 19<sup>th</sup> sitting held on 31st January, 2012 at 3.40 pm were proposed by the Hon. Yusuf Chanzu, M.P. and seconded by the Hon. Ntoitha M'Mithiaru, M.P.
- (v) The Minutes of the 20<sup>th</sup> sitting held on 2nd February, 2012 at 3.20 pm were proposed by the Hon. Peter Kiilu, M.P. and seconded by the Hon. Rachel Shebesh, M.P.
- (vi) The Minutes of the 21<sup>st</sup> sitting held on the 6th February, 2012 at 10.30 am were proposed by the Hon. Peter Kiilu, M.P. and seconded by the Hon. Rachel Shebesh, M.P.
- (vii) Confirmation of the Minutes for 12<sup>th</sup> and 18<sup>th</sup> sitting was postponed to a later sitting.

**MIN. NO.98/2011:**

**DELIBERATION ON THE REPORT**

- (i) The Committee resolved to consider the draft report as below:-

- Summary
- Findings
- Recommendations
- Introduction
- Government Agencies
- Banks
- Experts
- Other Institutions

- (ii) In considering the summary of the draft report, the Committee went through an overview of the report.

**MIN. NO.99/2011:**

**ADJOURNMENT**

There being no other business and the time being Three O'clock, the Chairman adjourned the meeting until Four O'clock.

SIGNED.....  
(CHAIRMAN)

DATE.....10/02/12.....

MINUTES OF THE 24<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON  
THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON  
THURSDAY, 9<sup>TH</sup> FEBRUARY 2012 AT SEVERIN SEA LODGE, MOMBASA AT 4.00 P.M.

PRESENT

- The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Emilio Kathuri, M. P.  
The Hon. Moses Lesonet, M.P

ABSENT WITH APOLOGY

- The Hon. Charles Kilonzo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Abdul Bahari, M.P.  
The Hon. Shakila Abdalla, M.P.

IN ATTENDANCE

- Mr. Boniface Mathooko  
Mr. George Otieno  
Ms. Caroline Kinyua  
Mr. Michael Karuru  
Mr. Robert Nyaga  
Mr. Benjamin Ng'imor  
Mr. Simon Muinde

KENYA NATIONAL ASSEMBLY

- Senior Researcher  
- Clerk Assistant  
- Clerk Assistant  
- Legal Counsel  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder

MIN. NO.100/2011:

- (i) The meeting started with a word of prayer.

MIN.NO.101/2011:

PRELIMINARY

- (i) The Minutes of the 12<sup>th</sup> sitting held on 19<sup>th</sup> December, 2011 at 2.30 pm were proposed by the Hon. Emilio Kathuri, M.P. and seconded by the Hon. (Dr) Erastus Muriithi, M.P.

CONFIRMATION OF MINUTES

- (ii) The Minutes of the 18<sup>th</sup> sitting held on 30<sup>th</sup> January, 2012 at 2.40 pm were proposed by the Hon. Yusuf Chanzu, M.P. and seconded by the Hon. Ntoitha M'Mithiaru, M.P.

MIN. NO.102/2011:

DELIBERATION ON THE REPORT

- (i) The Committee considered the Findings and the Recommendations of the report linking the two to the submissions that were made. In doing this, the Committee considered the submissions of various Banks.

MIN. NO.103/2011:

ANY OTHER BUSINESS

**Summon to Commercial Bank of Africa**

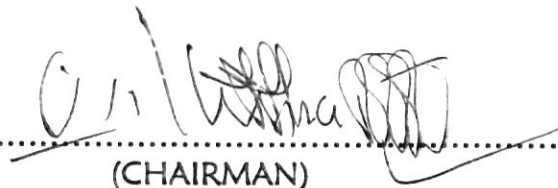
The Committee directed that a summon be sent to Commercial Bank of Africa (CBA) to appear before the Committee on Monday 13 February, 2012 at 11.30 a.m.

MIN. NO.104/2011:

ADJOURNMENT

There being no other business and the time being Twenty Minutes past Eight O'clock, the Chairman adjourned the meeting until Friday at 9.30 p.m.

SIGNED.....

  
(CHAIRMAN)

DATE.....

10/02/12

MINUTES OF THE 25<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON FRIDAY, 10<sup>TH</sup> FEBRUARY 2012 AT SEVERIN SEA LODGE, MOMBASA AT 9.30 A.M.

PRESENT

The Hon. Adan Keynan, M.P.	- Chairperson
The Hon. Rachel Shebesh, M.P.	- Vice Chairperson
The Hon. Peter Kiilu, M.P.	
The Hon. Ntoitha M'Mithiaru, M.P.	
The Hon. (Dr.) Erastus Mureithi, M.P.	
The Hon. Martin Ogindo, M.P.	
The Hon. Benjamin Langat, M.P.	
The Hon. Adan Bare Duale, M.P.	
The Hon. Jakoyo Midiwo, M.P.	
The Hon. Yusuf Chanzu, M.P.	
The Hon. Emilio Kathuri, M. P.	
The Hon. Moses Lesonet, M.P	
The Hon. Shakila Abdalla, M.P.	

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Abdul Bahari, M.P.

IN ATTENDANCE

Mr. Boniface Mathooko  
Mr. George Otieno  
Ms. Caroline Kinyua  
Mr. Michael Karuru  
Mr. Robert Nyaga  
Mr. Benjamin Ng'imor  
Mr. Simon Muinde

KENYA NATIONAL ASSEMBLY

- Senior Researcher  
- Clerk Assistant  
- Clerk Assistant  
- Legal Counsel  
- Fiscal Analyst  
- Fiscal Analyst  
- Hansard Recorder

MIN. NO.105/2011:

PRELIMINARY

The meeting started with a word of prayer.

MIN. NO.106/2011:

DELIBERATION ON THE REPORT

The Committee considered the Findings and the Recommendations of the report linking the two, to the submissions that were made. In doing this, the Committee considered the submissions of Government Agencies, banks, experts and other institutions.

MIN. NO.107/2011:

ANY OTHER BUSINESS

**Summon to Central Bank of Kenya and other banks**

The Committee directed that a summon be sent to the following banks for failing to avail records of CBK discount window borrowing for the last twenty four months and the records of foreign money holding for the last 24 months as was earlier requested vide a letter dated February 6, 2012:-

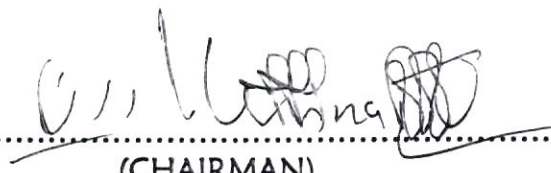
- Central Bank of Kenya (CBK) to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 10.00 a.m.
- Standard Chartered Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- Kenya Commercial Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- Citi Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- I and M Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- Diamond Trust Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- NIC Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- Equity Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- Cooperative Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- Bank of Africa to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- CFC Stanbic to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.
- Barclays Bank to appear before the Committee on Monday 13<sup>th</sup> February, 2012 at 11.30 a.m.

MIN. NO.108/2011:

ADJOURNMENT

There being no other business and the time being Twenty Minutes past Two O'clock, the Chairman adjourned the meeting until 3.00 O'clock.

SIGNED.....



(CHAIRMAN)

DATE.....

10/02/12

MINUTES OF THE 26<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON FRIDAY, 10<sup>TH</sup> FEBRUARY 2012 AT SEVERIN SEA LODGE, MOMBASA AT 5.00 P.M.

PRESENT

The Hon. Adan Keynan, M.P. - Chairperson  
The Hon. Rachel Shebesh, M.P. - Vice Chairperson  
The Hon. Peter Kiilu, M.P.  
The Hon. Ntoitha M'Mithiaru, M.P.  
The Hon. Martin Ogindo, M.P.  
The Hon. Benjamin Langat, M.P.  
The Hon. Jakoyo Midiwo, M.P.  
The Hon. Yusuf Chanzu, M.P.  
The Hon. Shakila Abdalla, M.P.  
The Hon. (Dr.) Erastus Mureithi, M.P.  
The Hon. Adan Bare Duale, M.P.  
The Hon. Emilio Kathuri, M. P.  
The Hon. Moses Lesonet, M.P

ABSENT WITH APOLOGY

The Hon. Charles Kilonzo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Abdul Bahari, M.P.

IN ATTENDANCE

KENYA NATIONAL ASSEMBLY

Mr. Boniface Mathooko - Senior Researcher  
Mr. George Otieno - Clerk Assistant  
Ms. Caroline Kinyua - Clerk Assistant  
Mr. Michael Karuru - Legal Counsel  
Mr. Robert Nyaga - Fiscal Analyst  
Mr. Benjamin Ng'imor - Fiscal Analyst  
Mr. Simon Muinde - Hansard

MIN. NO.109/2011:

PRELIMINARY

The Members were informed that the data asked for from the Central Bank had finally been sent to the Committee. The Central Bank Governor submitted to the Committee monthly data of foreign currency assets and liabilities for 2010 and 2011 and monthly data on Central Bank Window borrowing for 2010 and 2011 for the following banks:-

- CFC Stanbic Bank
- Kenya Commercial Bank
- Standard Chartered bank
- Citi Bank
- Barclays Bank
- Commercial Bank of Africa
- I & M Bank
- Diamond Trust Bank
- NIC Bank
- Equity Bank
- Cooperative Bank
- Bank of Africa

The Committee also received the Interbank and Central Bank Discount Window Rate from 2<sup>nd</sup> of June 2010 to 8<sup>th</sup> of February 2012.

#### CONFIRMATION OF MINUTES

##### MIN. NO. 110/211:

- (i) The minutes of the 22<sup>nd</sup> sitting held on the 7<sup>th</sup> February, 2012 at 2.20 pm were proposed by the Hon. Benjamin Langat, M.P. and seconded by the Hon. Peter Kiilu, M.P.
- (ii) The minutes of the 23<sup>rd</sup> sitting held on the 9<sup>th</sup> February, 2012 at 9.30 am were proposed by the Hon. Yusuf Chanzu, M.P. and seconded by the Hon. Moses Lesonet, M.P.
- (iii) The minutes of the 24<sup>th</sup> sitting held on the 9<sup>th</sup> February, 2012 at 4.00 pm were proposed by the Hon. Rachel Shebesh, M.P. and seconded by the Hon. Martin Ogindo, M.P.
- (iv) The minutes of the 25<sup>th</sup> sitting held on the 10<sup>th</sup> February, 2012 at 9.30 pm were proposed by the Hon. Shakilla Abdalla, M.P. and seconded by the Hon. Yusuf Chanzu, M. P.

##### MIN. NO.111/2011:

#### INTERROGATION OF THE CENTRAL BANK DOCUMENTS

The Members observed the following:-

- (i) That, the financial institutions were building up foreign currency assets particularly from April to July 2011. This was attributed to speculation by the banks.
- (ii) That, the rate of the discount window was lower than that of the interbank lending rates. This was noted with concern. This allowed some banks to borrow at low rates from the CBK for onward lending to other banks or to buy foreign currencies for speculation purposes.

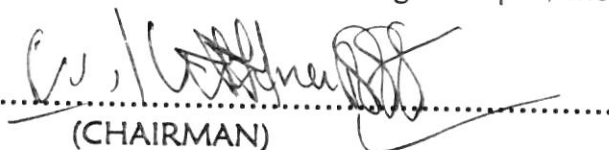
- (iii) That, the 12 banks named above should be investigated and a forensic audit be carried out on their trading in forex and discount window by Ethics and Anti Corruption Commission and the Auditor- General.
- (iv) That, the CBK Act should be amended to enhance the penalty for flouting the CBK regulations. Members proposed the fine to be 20 million or 50% of the amount in question whichever is higher to act as deterrence.
- (v) That, CBK allowed the Banks to abuse the Discount Window for speculative purposes. Indeed most banks were accumulating foreign currencies under the watch of the Central Bank of Kenya.

MIN. NO.112/2011:

ADJOURNMENT

There being no other business and the time being 6.05 pm, the Chairman adjourned the meeting.

SIGNED.....

  
(CHAIRMAN)

DATE.....

10/02/12

**MINUTES OF THE 27<sup>TH</sup> SITTING OF THE PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST OTHER CURRENCIES HELD ON FRIDAY, 10<sup>TH</sup> FEBRUARY 2012 AT SEVERIN SEA LODGE, MOMBASA AT 6.05 P.M.**

**PRESENT**

The Hon. Adan Keynan, M.P.	- Chairperson
The Hon. Rachel Shebesh, M.P.	- Vice Chairperson
The Hon. Peter Kiilu, M.P.	
The Hon. Ntoitha M'Mithiaru, M.P.	
The Hon. (Dr.) Erastus Mureithi, M.P.	
The Hon. Martin Ogindo, M.P.	
The Hon. Benjamin Langat, M.P.	
The Hon. Adan Bare Duale, M.P.	
The Hon. Jakoyo Midiwo, M.P.	
The Hon. Yusuf Chanzu, M.P.	
The Hon. Emilio Kathuri, M. P.	
The Hon. Moses Lesonet, M.P	
The Hon. Shakila Abdalla, M.P.	

**ABSENT WITH APOLOGY**

The Hon. Charles Kilonzo, M.P.  
The Hon. (Prof.) Philip Kaloki, M. P.  
The Hon. Benedict Gunda, M.P.  
The Hon. Chris Okemo, M. P.  
The Hon. Shakeel Shabbir, M.P.  
The Hon. Abdul Bahari, M.P.

**IN ATTENDANCE**

**KENYA NATIONAL ASSEMBLY**

Mr. Boniface Mathooko	- Senior Researcher
Mr. George Otieno	- Clerk Assistant
Ms. Caroline Kinyua	- Clerk Assistant
Mr. Michael Karuru	- Legal Counsel
Mr. Robert Nyaga	- Fiscal Analyst
Mr. Benjamin Ng'imor	- Fiscal Analyst
Mr. Simon Muinde	- Hansard Recorder

**MIN. NO.113/2011:**

**PRELIMINARY**

The meeting started with a word of prayer.

**MIN.NO.114/2011:**

**CONFIRMATION OF MINUTES**

The Minutes of the 26<sup>th</sup> sitting held on 10<sup>th</sup> February, 2012 at 5.00 pm were proposed by the Hon. Jakoyo Midiwoi, M.P. and seconded by the Hon. Peter Kiilu, M.P.

**MIN. NO.115/2011:**

**DELIBERATION ON THE COMMITTEE REPORT**

The Committee sittings isolated the primary drivers of the drastic depreciation of the Kenya shilling as economic, human and institutional failures. The economic causes such as the wide current account deficit, Euro crisis, large import bill of non-essential commodities, the Arab spring, are still in place even after the shilling recovered its value since December 2011. The Committee therefore zeroed on institutional and human failures. These factors include policy indecisiveness and inaction of the CBK, speculative activities of some banks and individuals, and inaction by the Ministry of Finance.

The Committee's findings on the cause for the sharp decline of the shilling were as follows:

- (i) **Policy indecisiveness and inaction of the Central Bank of Kenya (CBK)** - The Committee finds the following acts as directly linked to the slide of the shilling:
  - **Creating opportunities for arbitrage** - Failure by the CBK to detect and close in time the gap between the interest rate on Discount Window of the CBK, the rate on the interbank lending market and rates on Treasury bills and bonds. The Committee is convinced that commercial banks exploited this loophole for monetary gains. The problem of the exchange rate could have been addressed to a great extent through a rise in the CBR as early as June 2011 and also the placement of stringent penalties on the abuse of the Discount Window.
  - **Failure to detect and arrest speculative activities** - The Committee also found that the CBK failed to detect and arrest speculative activities of the financial market players through several financial instruments that fueled the sharp volatility and sudden fall of the shilling in 2011. This is related to weak monitoring and surveillance of financial markets.
  - **Unclear Communication to markets** - The Committee felt that CBKs communication strategy was ineffective during part of the year, and this may have created conditions for further speculative activities or unresponsiveness of market players to CBKs policy signals. Indeed, the signals from the CBK to the market and failure to intervene were creating more confusion in the market sparking panic buying by importers and increased speculation backed by series of circulars issued by CBK.

- **Ineffectiveness of the Monetary Policy Committee (MPC)** - The build up to the decline of the shilling was evident as early as January 2011, but the CBK through the MPC failed to discern the signals and stem the crisis before it reached its peak. The Committee observes there is ineffectiveness on the part of the MPC, especially its failure to meet regularly, its composition, and its inadequate response to the shilling's decline as one of the problems that worsened the situation last year.

- **Inadequate policy responses** – The Committee finds that policy responses were either inadequate or came in too late. Slow reaction of by the Central Bank of Kenya to the problem made exchange rate problem spiral out of control. Tracking CBKs response to the exchange rate and inflationary pressures throughout the year provides a hint on what went wrong. The CBK firstly increased the CBR on March 23, 2011 from 5.75% to 6% which was revised again to 6.25% on 4<sup>th</sup> June, 2011. The CBR rate was not reviewed again until September 15<sup>th</sup>. But this was raised to only 7% despite the fact that the Kenya shilling was rapidly losing value and inflation was rising. The CBK kept the CBR fairly flat for about 9 months.

- **Belated intervention by the CBK** – CBKs response through hiking the CBR rate to 18% was too drastic and costly to the economy. This has forced the banks to hike their lending rate to more than 30 percent for new and old loans. Kenyans are now at risk of becoming paupers due to high interest rate payments.

(ii) **Governor of the CBK** - The Committee finds that the CBK Governor:

- Did not react in good time to the problem of sharp decline of the shilling which triggered a panic and fertile ground for hoarding in dollars and speculation. This was corroborated by several commercial banks, the Taskforce, all the economic experts and other organizations.
- Kept CBK Discount Window interest rates below the interbank rate and Treasury bill rates that encouraged the commercial banks to by-pass the interbank market to borrow from the Discount Window.
- Allowed communication breakdown between the CBK and the banks.
- The governor played down the gravity of the problem to the extent that in various instances he was quoted in the media saying that he would not intervene in the foreign exchange market.

- Being less candid with information. For instance, the Governor claimed public in the media that some banks, which he refused to name, were responsible for arbitrage and hoarding of dollars. The Governor was therefore not candid enough and honest to the Kenyans and even to this Select Committee.
  - Overseeing the rise of the CBR rate to 18%, hence occasioning Kenyans heavy interest rate payments.
  - The Committee is of the view that the Governor is squarely responsible for creating the opportunity for banks and individuals to make quick money.
  - His announcement and release of CBK circular to bypass the banking system and deal directly with buyers or sellers of foreign exchange, although reversed, was in complete disregard of the financial structures. This could have opened opportunities for rationing of foreign exchange, occasioned parallel markets to thrive and creation of multiple currency practices. *(see taskforce report)*
- (iii) **Arbitrage by commercial banks** - Various financial players, including commercial banks participated in arbitrage. Although this is not illegal and is a common business practice, the Committee observed that banks exploited loopholes in the financial market to borrow funds from the CBK through the Discount Window and used the funds to profit from foreign exchange trading or to buy government securities. The Committee can infer that in fact banks were using the Discount Window to lend in the interbank market the same day or the next day since the Banking Circular No. 5 of June 29, 2011, Banking Circular No. 6 of July 11, 2011, and Banking Circular No. 8 of August 12, 2011 sought to curtail this practice. The Committee also found that Kenya Bankers Association, in a meeting with CBK, had expressed concern about the small discount window rate relative to the interbank market rates which was opening up opportunities for arbitrage.
- (iv) **Commercial Banks with increased foreign exchange trading activity** - Three banks namely: CFC Stanbic Bank, Standard Chartered Bank, and Citibank were reported to have had increased foreign exchange trading activity. CBK wrote to them seeking explanation. (see annex)
- (v) **Suspension of specific financial institutions from participating in the interbank market or foreign exchange market** - the Governor reported that CFC Stanbic Bank had flouted the guidelines issued on October 13, 2011 regarding the tenor of foreign currency swaps. The bank was suspended from participating in the swap market for 30 days and was also penalized Ksh. 1 million in line with the Banking Act (Section 2(a) of Legislation No. 77 of 1999: The Banking (Penalties) (Amendment) Regulations 1999).

- (vi) **Commercial Bank Foreign Exchanging holdings** - The committee finds that 12 major banks held 87.7% of total foreign assets by September 2011 (see Appendix).
- (vii) **Conflict of Interest** – the Committee finds that top management and board members in some banking institutions hold board positions in key public policy organs which are tasked with major development projects in the country. This is a source of disaffection among banks which feel undue advantage is gained by such bank executives. For instance, the CEO of Equity Bank chairs the Vision 2030 board which in the Committee's and other banking institutions provides undue advantage on present and future information about inflow of funds towards infrastructure development. Similarly, the chairman of Equity Bank chairs the National Oil Corporation.
- (viii) **Kenya Bankers Association** – The Committee found that Kenya Bankers Association (KBA) discussed the problem of monetary policy in a meeting with CBK. The Committee found that the interactions between the regulator and KBA, which is an interest group for profit seeking banks, was inappropriate in free markets. This opens up opportunities for collusion, arbitrage and speculation in foreign currencies.
- (ix) **Inaction by the Ministry of Finance** – The ministry of finance failed to exercise the provisions of the Central Bank Act (Cap 491 section 4c) and take a proactive role to tame the decline of the shilling. Under the law, Treasury can intervene (take over monetary policy) upon approval by the Cabinet for a period of 6 months if the CBK shows inability or unwillingness to pursue the intended monetary policies.
- (x) **Working relationship between the CBK and commercial banks** - the poor relationship between these financial players necessitated the formation of a taskforce in the office of the Prime Minister. However, this did little to arrest the direction of the Kenya shilling.
- (xi) **Failure by the fiscal and the monetary policy organs of the government** - to take timely corrective measures to arrest the slide of the shilling against major currencies. The Committee finds that the CBK was far too slow to react to the problem of the shilling which triggered a panic and fertile ground for hoarding in dollars and speculation.
- (xii) **Capital Flight** -The country suffered capital flight during the period when the Kenya shilling was depreciating. The uncertainties about the unpredictable exchange rate of the Kenya shilling fuelled negative expectations about the economy and key macroeconomic variables. The fall of the NSE 20 share index from 4464.9 points in January 2010 to 3120.88 in December 2011 was partly associated with the increased activity among foreign investors at the stock market.

The capital market authority failed to share with the Committee the magnitude of capital flight from the NSE and major actors involved.

- (xiii) **Global economic crisis**– The Committee finds factors external to the domestic economy to have played a role in the decline of the shilling. These include Eurozone debt crisis, US debt crisis, and Political events in the Middle East and North Africa. However, since these conditions still persist, the committee considers them not have been the main causes for the drastic depreciation of the shilling.

### Committee Recommendations

On the basis of the above findings, the Committee has drawn a range of recommendations which will ensure that future crisis such as the sharp depreciation of the shilling is not replicated. The Committees' recommendations span both economic and institutional changes as follows:

#### (i) Monetary Policy

- **Governor of the CBK** –Failures attributable to the CBK during the period of the decline of the shilling, and the Governors own conduct bordering on incompetence created panic and fertile ground for banks and individuals to make quick money. The committee finds the Governor's conduct and behavior incompatible with the holder of the office of Governor of the Central Bank of Kenya and therefore recommend:
  - The Governor takes responsibility for allowing the sharp decline of the shilling.
  - That the President should constitute a Tribunal to investigate the Governor's conduct, incapability and incompetence to perform the functions of the office as per the provisions of the CBK Act Cap 491 section 14 (2)(f) and 14(3).
- **Productive communication between CBK and financial market players** - the Committee recommends that CBK should design a framework of engaging with foreign exchange market players within the confines of the financial market laws and regulations.
- **Coherence of monetary policy** - The Committee found that the CBK may have been overenthusiastic about economic stimulus and also maintained the low interest rate regime for far too long. The Committee therefore recommends that the CBK should maintain a coherent monetary policy at all times with a focus on price stability.

- **Early warning mechanism** - CBK should put in place thresholds or trigger values for which the foreign exchange should fluctuate in times of extreme crisis and at which the CBK would move in to restore stability.
- **Strengthen reserve position of the CBK** - The Committee recommends that the government should take adequate steps to boost the reserve position to at least the 4 months of import cover to strengthen its ability to respond to market volatility.
- **Enforcement of the In-Duplum rule** – The In-Duplum rule as provided under section 44A of the Banking Act needs to be enforced. In addition, the Act needs to be amended to apply to all loans – both performing and non-performing.

## (ii) Legal Amendments

Suggested amendments to the CBK Act can target, but are not restricted to the following:

- **Position of Chair and deputy Chair of the CBK Board** - The Central Bank Act (CAP 491 section 11 (1)(a)(b)) should be amended to provide that the CBK governor and the deputy governor cannot chair the Board of Directors which is expected to review his performance in achieving the CBK core mandates.
- **Appointment of the Governor and deputy governor** - The Committee recommends that the CBK governor and deputy governor be recruited through a competitive process.
- **Oversight over CBK** - The Committee also recommends that the CBK Act should be amended to provide that the CBK governor appears on a quarterly basis before a relevant parliamentary committee of the National Assembly to expound on monetary policy and other actions related to the discharge of the CBK core mandate of price stability and financial stability.
- **Autonomy of the CBK** – Strengthen the autonomy of the two arms of CBK namely, the bank supervision/financial markets on one hand and monetary policy arm on the other.
- **Sanctions** - To provide for punitive sanctions on the Management of the Bank for gross failure in attainment of important monetary policy objectives or failure which occasions the country huge losses, the Committee recommends the introduction of amendment to the CBK Act.

- **The Monetary Policy Committee** – To include the input of supervisory arm of CBK in monetary policy decision making, the Committee proposes amendment of CBK Act to provide for an extra member to the MPC of a CBK staff responsible for bank supervision. The performance of the MPC during the crisis and in particular the handling of the sharp depreciation of the shilling was found to be wanting. The Committee recommends a reconstitution of the current MPC to reflect the requisite expertise that will inform the monetary policy direction in the country.
- **Conflict of interest**– To provide for a fair and level playing field in the banking sector and to avoid conflict of interest, the Committee recommends that senior managers and board members of banks should not hold positions in government policy organs or government commissions with direct impact on financial and monetary policies.

### (iii) Supervisory Oversight of Financial Institutions

- **Tools to efficiently monitor financial markets** - CBK needs to develop tools to properly and efficiently monitor the financial markets, particularly find tools to quickly deal with the adverse effects of innovations in foreign exchange trades such as the Electronic Brokerage System, foreign exchange swaps and carry trades.
- **Responsiveness to market developments** - The CBK should increase the speed and responsiveness to market developments to deal with rapidly changing financial market behavior.
- **Independent forensic audit** - Possible speculation and abnormal trading in foreign exchange could have been prevented if action was taken in a timely manner. The Committee also recommends
  - EACC and the Auditor General's office to carry out an independent forensic audit on the operations and transactions of the discount window and foreign exchange trading of twelve banks which had the largest foreign exchange holdings by September 2011. see annex
  - The CMA to conduct a comprehensive investigation of the NSE to determine whether there were institutions that involved in suspect capital inflows and outflows from the bourse and report to parliament within 90 days from the date of adoption of this report by the House.
- **Review of internal processes** - The Committee recommends that the CBK carries out an internal audit of what went wrong in monetary operations and bank supervision with a view to rectifying the problem.

- **Banking penalties regulations** – The Committee recommends amendments be made to the CBK Act and the Banking Act in order to revise and enhance the penalties which may be imposed for breach of CBK regulations. Such penalties should be proportionate of the value to the bank of the malpractice at that particular time. The committee found the amount of penalty, Ksh. 1 million too lenient and therefore recommends a more deterrent penalty of 50% of the amount involved (regulation 2 of the banking (penalties) Regulations, 1999).

(iv) **Fiscal Policy**

- **Reduction of the current account deficit through exports promotion.**
- **Placing tariffs and non-tariff barriers on non-essential imports** - To reduce the import bill, the Ministry of Finance should explore ways through the regional trading arrangements to increase tariffs on non-essential commodities.
- **Exercise of powers provided under the law** - The Committee recommends that the Ministry of Finance should not hesitate to take policy measures if the CBK grossly deviates from its monetary policy statement.
- **Strong macroeconomic fundamentals** - The committee finds the CBK and the Treasury lacking in strong macroeconomic fundamentals in the form of policy. Both institutions appear to have been overenthusiastic about economic stimulus. The CBK also maintained the low interest rate regime for far too long. The Committee therefore recommends that the CBK should maintain a coherent monetary policy at all times with a focus on price stability.
- **Coordination between the monetary and fiscal policy institutions** - The effectiveness of the monetary policy in a country must be matched with an equally effective fiscal policy, particularly so when dealing with a crisis of the magnitude the decline in value of the shilling. Fiscal spending remained high before some austerity measures were issued. The Committee recommends effective policy coordination between the fiscal and monetary authorities/agencies.

Finally, the Government, CBK and financial market players should put in place deliberate mechanism to make interest rates affordable and address the after effects of the crisis.

MIN. NO.116/2011:

ADOPTION OF THE REPORT

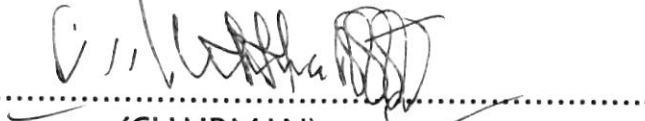
The Committee report was adopted as proposed by The Hon. Jakoyo Midiwo, M.P. and seconded by The Hon. Peter Kiilu, M.P.

MIN. NO.117/2011:

ADJOURNMENT

There being no other business and the time being Ten Minutes past Eight O'clock, the Chairman adjourned the meeting.

SIGNED.....

  
(CHAIRMAN)

DATE.....

10/02/12

MEMBERS PRESENT DURING THE ADOPTION OF THE  
 PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE  
 OF THE KENYA SHILLING AGAINST FOREIGN CURRENCIES

NAME	SIGNATURE
1. Hon Adan Duale, MP	<i>Adan Duale</i>
2. Hon Rachel Sheberish, MP.	<i>Rachel Sheberish</i>
3. Hon. Emilio Katturi, MP.	<i>Emilio Katturi</i>
4. Hon Dr. E.K. Mureithi MBE, HSE	<i>E.K. Mureithi</i>
5. Hon Aden Duale	<i>Aden Duale</i>
6. Hon Rachel Sheberish	<i>Rachel Sheberish</i>
7. Hon. Shauila Abdalla.	<i>Shauila Abdalla</i>
8. Hon Benjamin Kibet	<i>Benjamin Kibet</i>
9. Hon. Yusuf Chanze	<i>Yusuf Chanze</i>
10. Hon Peter Kiuku	<i>Peter Kiuku</i>
11. Hon Lessonet Moses K	<i>Lessonet Moses</i>
12. Hon. Motta M'ithiamu	<i>Motta M'ithiamu</i>
13. Hon Adan Keynan	<i>Adan Keynan</i>
14. Hon. Martin Ogindo	<i>Martin Ogindo</i>
15. JAKOYO MUDIMO	<i>JAKOYO MUDIMO</i>

# 3. CBK Regulatory Interventions:

## Banking Circulars/Letters

Date	Circular/Letter	Objective
1. 23rd Mar 2011	Banking Circular No. 2 of 2011 that revised the Central bank of Kenya (CBR)	<ul style="list-style-type: none"> <li>Increased the CBR by 25 basis points from 5.75 to 6.0%</li> </ul>
2. 4th Jun 2011	Banking Circular No. 4 of 2011 that revised the Cash Reserve Requirements and CBR	<ul style="list-style-type: none"> <li>Increased the Cash Reserve Requirement by 25 basis points from 4.5% to 4.75</li> <li>Increased CBR from 6% to 6.25%</li> </ul>
3. 29th June 2011	Banking Circular No. 5 of 2011 that revised the rules that guide the operations of the CBK Discount Window.	<ul style="list-style-type: none"> <li>Set the discount window rate at 8% well above the CBR. Also announced that this rate would be reviewed from time to time and posted on the CBK website daily at 9.00 am.</li> <li>Announced stiff penalties for banks using funds from the CBK Window to trade in the interbank market.</li> </ul>
4. 11th July 2011	Banking Circular No. 6 of 2011 that reviewed guidelines on the use of CBK Discount Window	<ul style="list-style-type: none"> <li>Banks lending in the interbank barred from accessing Window funds on the same day</li> <li>In a week (Monday-Friday) banks were restricted to borrow from the window a maximum of their statutory cash reserves</li> <li>Window rate reviewed downwards to 6.25% from 8.00%</li> <li>Signaled banks to consider liquidating their Treasury bills, bonds or foreign currency positions prior to resorting to CBK Window</li> </ul>
5. 28th July 2011	Banking Circular No. 7 of 2011 that announced the MPC decision	<ul style="list-style-type: none"> <li>CBR maintained at 6.25%</li> <li>Introduced weekly averaging on cash reserves instead of the daily and banks were allowed to deviate from the 4.75% provided the five-day average of 4.75% was met.</li> </ul>



# 3. CBK Regulatory Interventions...

## Banking Circulars/Letters...

Date	Circular/Letter	Objective
6. 12 <sup>th</sup> August 2011	Banking Circular No. 8 of 2011 that provided further guidelines on the CBK Discount Window	<ul style="list-style-type: none"><li>• Any bank accessing funds from the CBK window was not allowed to lend in the interbank market either on the same day or the following day.</li><li>• Window rate = CBR + (Average interbank rate for the previous day-CBR) + 3% Penalty</li><li>• Eligibility to access funds from CBK Window would be determined by among other things, an individual bank's foreign exchange trading behavior over the previous four trading days.</li><li>• Reverse repos were suspended until the stance on monetary policy was changed.</li></ul>
7. 26 <sup>th</sup> August 2011	Banking Circular No. 9 of 2011 that provided more guidelines on liquidity management and CRR	<ul style="list-style-type: none"><li>• Reviewed the formula for Window rate to reflect market conditions by introducing a weight for the gap between average interbank rate and CBR and expanded the period for the average interbank rate component. (<i>Average period was not announced but was actually 2 days</i>). CBR was the floor.</li><li>• Expanded averaging of cash reserves from weekly to monthly but limited the deviation to a minimum of 3% failure to which penalties would be effected.</li></ul>
8. 15 <sup>th</sup> Sept. 2011	Banking Circular No. 10 of 2011 that announced the MPC decision at a special MPC meeting held on 14 Sept. 2011.	<ul style="list-style-type: none"><li>• CBR adjusted upwards from 6.25% to 7.00% to rein in inflation and exchange rate instability.</li></ul>

# 3. CBK Regulatory Interventions...

## 1 Banking Circulars/Letters...

Date	Circular/Letter	Objective
9. 6 <sup>th</sup> Oct. 2011	Banking Circular No. 11 of 2011 that announced the MPC decision of 5 <sup>th</sup> Oct. 2011	<ul style="list-style-type: none"><li>• CBR adjusted upwards from 7.00% to 11.00% to tame inflationary pressure, stabilize exchange rate and re-establish a strong growth base.</li><li>• MPC meetings to be held monthly usually in the first week of the month until further notice.</li></ul>
10. 13 <sup>th</sup> Oct. 2011	Letter to Chief Executive Officers of commercial banks that extended foreign exchange guidelines	<ul style="list-style-type: none"><li>• Reverse-carry transactions that had been introduced into the market, and are unrelated to economic activity, and which have not been utilised for domestic purposes were limited to a minimum tenor of one year.</li><li>• Foreign currency swaps involving Kenya shillings were limited to a minimum tenor of seven days.</li><li>• Reviewed downwards the foreign exchange exposure limits from 20% to 10% of core capital</li></ul>
11. 18 <sup>th</sup> Oct. 2011	Further clarifications on the letter dated 13 <sup>th</sup> October 2011 to commercial banks	<ul style="list-style-type: none"><li>• Clarified that foreign currency swaps and forward transactions involving Kenya shillings for non-resident financial institutions will be limited to a minimum tenor of one year.</li></ul>

# 3. CBK Regulatory Interventions...

## Banking Circulars/Letters...

Date	Circular/Letter	Objective
12. 2 <sup>nd</sup> Nov. 2011	Banking Circular No. 13 of 2011	Announced the decision of the MPC <ul style="list-style-type: none"><li>• CBR adjusted upwards from 11 to 16.5% to provide an enhanced monetary policy tightening stance – effective immediately.</li><li>• CRR adjusted upwards from 4.75% to 5.25% effective from 15<sup>th</sup> December, 2011</li></ul>
13. 2 <sup>nd</sup> Dec. 2011	Banking Circular No. 14 of 2011	Announced the decision of the MPC <ul style="list-style-type: none"><li>• CBR adjusted upwards from 16.5% to 18.0% to provide an enhanced monetary policy tightening stance – effective immediately.</li></ul>

## 2. Background Support Information... **ANNEX 3**

### *Foreign Exchange Holding by Banks*

This is Published data for the Quarter ending September, 2011 (Ksh '000)

	Total foreign assets		
	Total	Percentage	Cumulative Percentage
1. CFC Stanbic Bank (K) Ltd	70,425,709	17.0%	17.0%
2. Kenya Commercial Bank Ltd	57,476,699	13.9%	30.9%
3. Standard Chartered Bank (K) Ltd	46,561,144	11.3%	42.2%
4. Citibank N.A. Kenya	29,179,720	7.1%	49.2%
5. Barclays Bank of Kenya Ltd	26,562,409	6.4%	55.6%
6. Commercial Bank of Africa Ltd	26,086,714	6.3%	61.9%
7. I&M Bank Ltd	23,252,309	5.6%	67.6%
8. Diamond Trust Bank (K) Ltd	22,094,803	5.3%	72.9%
9. NIC Bank Ltd	20,295,571	4.9%	77.8%
10. Equity Bank Ltd.	15,372,270	3.7%	81.5%
11. Co - operative Bank of Kenya Ltd	13,355,225	3.2%	84.8%
12. Bank of Africa (K) Ltd	12,081,122	2.9%	87.7%
13. Prime Bank Ltd	7,460,201	1.8%	89.5%
14. Ecobank Kenya Ltd	5,634,517	1.4%	90.8%
15. Chase Bank Ltd	4,209,584	1.0%	91.9%
16. Imperial Bank Ltd	4,002,460	1.0%	92.8%
17. Bank of Baroda (K) Ltd	3,286,322	0.8%	93.6%
18. Development Bank of Kenya Ltd	2,789,762	0.7%	94.3%
19. Bank of India	2,745,930	0.7%	95.0%
20. Gulf African Bank Ltd	2,437,214	0.6%	95.6%
21. National Bank of Kenya Ltd	2,421,127	0.6%	96.1%

- 5 banks hold more than 50 percent of foreign assets



## 2. Background Support Information...

### *Foreign Exchange Holding by Banks...*

This is Published data for the Quarter ending September, 2011 (Ksh '000)

	Total foreign assets		
	Total	Percentage	Cumulative Percentage
22. African Banking Corporation Ltd	2,066,768	0.5%	96.6%
23. Fina Bank Ltd	2,053,907	0.5%	97.1%
24. Equatorial Commercial Bank Ltd	1,572,921	0.4%	97.5%
25. Middle East Bank (K) Ltd	1,421,871	0.3%	97.9%
26. Habib Bank Ltd	1,137,728	0.3%	98.1%
27. Habib Bank A.G. Zurich	1,065,561	0.3%	98.4%
28. Giro Commercial Bank Ltd	980,285	0.2%	98.6%
29. Victoria Commercial Bank Ltd	887,454	0.2%	98.8%
30. Fidelity Commercial Bank Ltd	887,007	0.2%	99.1%
31. Guardian Bank Ltd	675,587	0.2%	99.2%
32. First Community Bank Ltd	646,786	0.2%	99.4%
33. UBA Kenya Ltd	629,866	0.2%	99.5%
34. Credit Bank Ltd	486,256	0.1%	99.6%
35. Dubai Bank Ltd	294,378	0.1%	99.7%
36. Tran-national Bank Ltd	276,269	0.1%	99.8%
37. Oriental Commercial Bank Ltd	226,317	0.1%	99.8%
38. Paramount Universal Bank Ltd	188,976	0.0%	99.9%
39. Consolidated Bank of Kenya Ltd	136,700	0.0%	99.9%
40. Family Bank Ltd.	100,453	0.0%	100.0%
41. K - Rep Bank Ltd	35,972	0.0%	100.0%
42. Jamii Bora Bank Ltd	743	0.0%	100.0%
43. Housing Finance Ltd	-	0.0%	100.0%
<b>INDUSTRY TOTAL</b>	<b>413,714,183</b>	<b>100.0%</b>	<b>100.0%</b>



## TALKING NOTE

### MEETING WITH THE SELECT PARLIAMENTARY SELECT COMMITTEE TO DISCUSS THE ISSUE OF THE DECLINE OF THE KENYA SHILLING AGAINST FOREIGN CURRENCIES

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#### I. Introduction

1. The Parliamentary Select Committee on the Decline of the Kenya Shilling against Foreign Currencies is scheduled to meet with the DPM&MF tomorrow Wednesday 24<sup>th</sup> January 2012 at 11.30 am in 1<sup>st</sup> Floor, County Hall.

2. The issues the DPM&MF is expected to address, as forwarded in an earlier letter (see attached), include but not limited to the following:

- a. Causes of the exchange rate depreciation against the foreign currency and inflation;
- b. Fiscal remedies for the exchange rate depreciation and inflation;
- c. The involvement of IMF in the situation; and
- d. Whether that involvement of IMF is not aggravating the situation by adding to the public debt.

3. As a prelude, the DPM&MF may wish to brief the Hon. Members on the various Statements Treasury has made on the issue even before the Committee was set up, articulating what the government in general and the Central Bank in particular was doing to address it.

#### Brief update on the Subject Matter

4. In June and July, the DPM&MF issued a **Ministerial Statement** to the Parliament on the developments in the shilling exchange rate in response to the request by the Member for Gwasi, Hon. John Mbadi, and Member for Githunguri, Hon. Njoroge Baiya who had sought for the same on 16<sup>th</sup> June 2011 and 26<sup>th</sup> July 2011, respectively. In November 2011, the Minister issued a Press Statement on the same subject matter.

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5. In all these communications, the DPM&MF had stated the causes of rising inflation and the weakening of the shilling, as well as announcing measures the Government was taking to arrest the situation. Since then, the shilling has firmed to trading at around Ksh. 85 per US dollar currently.


6. Therefore, this meeting with the Select Committee will draw from these communications.

## II. Factors behind the weakening of the shilling and rising inflation

### *On exchange rate:*

7. **Hon. Members**, since January 2011 the shilling weakened against the US dollar by over 30 percent to exchange at an historic low of **Ksh. 107 in mid-October 2011**. This sharp and volatile movement of the Kenya shilling exchange rate raised concerns to investors and the public at large. In addition, it exacerbated inflation given that most intermediate and capital goods are imported. The cost of depreciation has largely offset the benefit it has on exports.

8. **Hon. Members**, the weakening of the shilling against the major currencies is attributed to both external and internal factors.

- 
- **First**, the exchange rate reacted to increased demand for foreign exchange. The demand for foreign exchange increased due to heavy imports, particularly of machinery and capital goods to support investment in energy and other infrastructure spending.
  - **Secondly**, since the beginning of the year, the demand for foreign exchange has increased sharply owing to the extraordinarily sharp rise in the international prices of crude oil. This was associated with the political crisis in the Middle East and North African (MENA) region. The demand for foreign exchange increased even further with importation of maize following the adverse impact of drought in Kenya and the Horn of Africa.
  - **Thirdly**, the high oil price and food imports created a perception of inadequate supply of foreign exchange in Kenya's interbank market. As

such, demand pressures spiralled with market players taking dollar positions that were largely driven by uncertainty in the market.

- **Finally**, inflation in Kenya has accelerated, and has been significantly higher than in our trading partners in the western world. The inflation differential, as would have been expected, weakened the value of our currency relative to those of our trading partners.

9. The depreciation of the shilling led to increased cost of fuel and transportation, as well as other imported raw material, thereby putting further pressure on inflation and increasing the cost doing business. It is worth noting that the weaker shilling has also complicated the management of the national budget as the shilling cost of government external debt increased and thus putting pressure on budgetary resources.

#### ***On Inflation:***

10. The failure of rain during the shortfall season in 2010 and below normal level rainfall during the long rains season in 2011 caused food shortages which saw the food prices escalate rapidly. Transportation costs also increased with higher fuel prices that were further compounded by the depreciation of the exchange rate.

11. Inflation also increased due to increase in **electric power prices** with as use of thermal energy had to be increased due to the **adverse impact of the drought on hydro power generation**.

12. On the demand side, private sector credit expansion was stronger-than-programmed reaching 36 percent in October 2011, despite CBK's efforts to contain monetary expansion. The strong domestic private demand spilled over to imports, thus causing a deterioration of the current account of the balance of payments and further exacerbating the weakening of the exchange rate. The current account deficit increased to an all time high of about 10 percent of GDP.

13. Meanwhile, fiscal policy has generally been constrained with lower fiscal deficit outcome and thus helping to minimize pressure on aggregate demand and hence on domestic prices. **For instance, we closed the financial year 2010/11 with a deficit of 4.5% of GDP against a target of 6.1% of GDP, as a result of a gradual fiscal consolidation.** The government has generally restrained from pursuing an expansionary fiscal

policy; otherwise if this were not the case inflation would have been even much higher.

### III. Actions the Government took to stabilize inflation and the shilling exchange rate

14. **Hon. Members**, I wish to inform you that arising from the coordinated actions, the Central Bank of Kenya has already taken appropriate measures to address the issue. These measures include:

- Tightening of monetary policy by raising the policy rate by 400 basis points to 11 percent in October, then by 550 basis points to 16.5 percent in November, and lately by another 150 basis points to 18 percent. This action has tightened credit conditions and it is expected to reduce demand pressure, which will in turn ease inflation and help stabilise the exchange rate.
- Lowered the foreign exchange exposure limit of commercial banks from 20% to 10% to enable banks offload their extra holding of foreign exchange to support genuine demand for foreign exchange.

15. It is also important to note that with the easing of food prices, lowering of fuel prices, and firming of the shilling exchange rate to about Ksh. 85 to the US dollar, inflation has eased to 18.7% in December 2011 from 19.7% in November. We expect further easing in inflation in the coming months.

16. **On the fiscal side**, to mitigate the impact of tightening monetary policy on interest rates, the Government has taken austerity measures reviewed its recurrent expenditure with a view to cutting back on non-productive spending. From these measures we expect to save about 4-5 billion shilling that will be channelled to new priorities that have recently emerged.

17. We are mindful that containing government spending will contribute to easing inflationary pressures and reducing imports, thus helping to stabilize the shilling. Overall, the Government is committed to living within the budget framework that was announced in the budget statement for FY 2011/12. In particular:

- a. We have further committed to lowering our fiscal deficit by 1% of GDP over the medium term from the original target in the Budget Policy Statement submitted in March 2011. Half of the targeted reduction (that is 0.5% of GDP) will be undertaken in the current fiscal year 2011/12.
- b. This tightening is being undertaken against a backdrop of the current challenges, including the current security operations in Somalia, salary demands from teachers, lecturers and doctors, as well as implementation of the new constitution.

18. The revised budget reflecting the above changes will be presented to Parliament in the context of the next supplementary budget shortly.

19. **Hon. Members**, with these measures the pressures on the exchange rate has subsided and indeed the shilling has firmed up against the major currencies.

#### IV. Involvement of the IMF

20. Let me take this opportunity to update the **Hon. Members** on our current relation with the IMF.

21. Very briefly, the IMF Executive Board in January 2011 approved a request by the Government for support of its economic programme under the **Extended Credit Facility (ECF)**. The credit is for SDR 325.7 million (equivalent to US\$ 509 million) over the next three-year facility. The first disbursement of SDR 64 million (about US\$ 100 million) was drawn in February 2011.

22. The Government successfully completed the First Review of the ECF programme in end-June 2011 and received the second disbursement of SDR 43.4 million (about US\$ 70 million) in early July 2011.

23. We have just successfully completed the Second Review with the IMF Executive Board approving, on **9<sup>th</sup> December 2011**, the disbursement of the third tranche amounting to SDR 43.4 million (about US\$ 70 million). In addition, the IMF approved the expansion of access under the current ECF arrangement, meaning we will receive an additional US\$ 75 million as per our request.

24. The additional resources will help us deal effectively with the emerging external and domestic shocks that have led to rising inflation and weakening of the shilling exchange rate, as well as boost the official foreign exchange reserves held by the Central Bank of Kenya.

**V. Does the Involvement with IMF aggravate the public debt situation?**

25. I wish to inform the Hon. Members that our public debt remains sustainable with the Net Present Value (NPV) of total public debt to GDP at 39 percent, which is below the 40 percent threshold. This is supported by results from a joint IMF/World Bank Debt Sustainability Analysis (DSA) conducted in November 2011.


26. Even with additional borrowing from the IMF, which in itself very highly concessionary given the terms of the loan (zero interest rate, with a grace period of 5½ years, and a final maturity of 10 years), our debt to GDP ratio will not increase much and we will still be well within our debt sustainability thresholds.

**VI. Conclusion**

27. In conclusion, you may wish to reaffirm that the underlying economic conditions remain broadly sound, and we as a government are alert and remain fully committed to take further actions to ensure macro-economic stability is restored. You could note that we are generally satisfied with the trend of the exchange rate and remain confident that in the near future we should begin to see inflation trending in the right direction. But to sustain the initial improvements we have noticed requires all Kenyans, that is, the private sector, the government as well as the wananchi to work together towards the common good of our country. This is the time to sacrifice ourselves and refrain from asking for wage increases as such actions will only aggravate the situation.

THE NATIONAL TREASURY

January 24, 2012

  
Hon. Dr. Oburo Ojwang  
Assistant Minister - Finance

## ANNEX I: OFFICE OF THE PRIME MINISTER INTERNAL MEMO

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TO : Prime Minister  
THRO' : The Permanent Secretary  
FROM : Director, Economic Policy Coordination Unit  
DATE : 28/09/2011

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### Re: Brief on Current Exchange Rate and Inflation Developments in Kenya

As you are aware, the Kenya shilling has come under intense pressure for the past several months. The shilling has lost about KShs 20 since the beginning of the year and was trading at about KSh102 per US dollar as at yesterday. This represents nominally the lowest level in the history of the Kenya currency. The weak shilling has increased the competitiveness of local exporters and would potentially increase the propensity of manufacturers of exports to create more jobs. However, while a weaker currency should benefit our exporters and may have a positive short-term impact on growth, the weak shilling may exacerbate inflation concerns.

Higher food and fuel prices experienced over the recent past are already having serious macroeconomic effects, including adverse effects on growth and inflation, and creating large swings in the terms of trade—all with important balance of payments repercussions. While fuel prices feed through to other prices through second-round effects, the immediate impacts on inflation are still dominated by food prices. With the depreciation of the shilling against the dollar, prices of imported goods and services, in shilling terms, have and continue to rise. This development has raised inflation expectations, which is already applying an upward pressure on interest rates and also on wages. Rising inflation paves the way to higher interest rates and that in turn will damage economic growth, employment, and income that are needed to achieve MDGs and vision 2030 objectives. Whatever is the cause, the fact remains that inflation needs to be tackled with great urgency.

Hitherto, the Government has undertaken short term measures to ease inflation by waiving excise duty on kerosene, diesel, maize and wheat in addition to raising minimum wage. These short term measures, however, are not adequate in absorbing the full impact of high fuel and food prices that are now being raised further by the weakening of the Kenya shilling. Moreover, while the CBK is doing its best using monetary policy to fight inflation in addition to managing the exchange rate, its efforts are hampered by the fact that it does not have sufficient instruments to tackle supply shortages. Already, the CBK has resorted to some form of exchange controls to deal with the weakening of the shilling. The attached press release shows that the CBK will henceforth buy and sell foreign exchange directly to targeted sectors of the economy which are most beneficial to the widest public. The danger with this approach is that it may create rent seeking opportunities and worsen the situation in the long run. CBK's action may create a two-

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the (i.e. parallel) currency market unless it moves further to determine where the interbank trading will take place.

A lasting solution stems from a 'whole of government approach' to tackling the weakening shilling and the associated high inflation and interest rates. For this reason, the Prime Minister is requested to constitute and chair a high level inter ministerial committee to discuss, in particular, the problems of high inflation, weak exchange rate and rising interest rates. The committee is proposed to be composed of senior officers from the Office of the President, the Office of the Prime Minister, The Ministry of Finance/Treasury, The Central Bank of Kenya (CBK), The Ministry of Planning, National Development and Vision 2030, the Kenya National Bureau of Statistics (KNBS) and the Vision 2030 Secretariat immediately embarked on coming up with measures to address the depreciation of the Kenya Shilling

Attached hereto is a brief on the shilling exchange rate developments.



Dr Chris Kiptoo

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**ANNEX II:**

**REPORT OF THE HIGH LEVEL COMMITTEE  
FORMED BY THE PRIME MINISTER TO COME  
UP WITH COMPREHENSIVE MEASURES TO  
ARREST THE SHARP WEAKENING OF THE  
KENYA SHILLING**

*COMMITTEE COMPOSED OF MEMBERS FROM:*

*The Central Bank of Kenya  
Ministry of Finance/the Treasury,  
The Ministry of Planning, National Development and Vision 2030,  
The Vision 2030 Secretariat  
Kenya National Bureau of Statistics  
Office of the President,  
Office of the Prime Minister  
Kenya Private Sector Alliance (KEPSA)*

4<sup>TH</sup> OCTOBER 2011

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## 1. Introduction

- 1.1. Since the beginning of 2011, the Kenyan shilling has weakened substantially against both international and regional currencies. Between 3<sup>rd</sup> January 2011 and 27<sup>th</sup> September 2011, the Kenya shilling weakened by over 20 percent against most international currencies especially the US Dollar which now trades at over Kshs 100 per US\$. This represents nominally the lowest level in the currency's history.
- 1.2. While a weaker currency should benefit the exporters and may have a positive short-term impact on growth, it exacerbates inflation concerns. The exchange rate depreciation coupled with rising inflation risks could see an increase in long-term debt yields. Ultimately, the shilling depreciation will hurt the Kenyan economy given that it is import dependent for energy and other inputs for critical sectors.
- 1.3. In response to these concerns, the Rt. Hon. Prime Minister set up a high level committee last week after meeting key stakeholders in government to address the problem of the sharp weakening of Kenya shilling. The committee, which is composed of senior officers from the Office of the President, Treasury, The Central Bank of Kenya (CBK), Office of the Prime Minister, the Ministry of Planning, National Development and Vision 2030, the Kenya National Bureau of Statistics and the Vision 2030 Secretariat immediately embarked on the task of coming up with measures to address the depreciation of the Kenya Shilling.

## 2. Main Issues Identified by the Committee

- 2.1 While recognizing the measures already taken by the CBK to address this problem, the committee critically looked at the available statistics and the prevailing economic fundamentals. It also benefited from the consultative meeting chaired by the Rt. Hon. Prime Minister held between the Kenya government and the private sector, in particular Kenya Private Sector Alliance (KEPSA) that included the Kenya Bankers Association (KBA).
- 2.2 The committee observed that the recent attempts to keep interest rates low, inflation in check and exchange rate stable in the face of exogenous factors and rising fiscal spending on much needed infrastructure has not produced desired results. The obtaining situation in the country now is that of accelerating inflation, exchange rate depreciation, and rising interest rates, all feeding into each other.
- 2.3 The committee observed that adverse shocks have played a role in widening the current account deficit, raising inflation, and slowing down growth. In particular, the committee analyzed current account trends over the recent past, the fluctuations and variations in the outcome relative to previous periods; and checked for any persistent and repeated

outcomes. The committee found that deterioration in the current account has been gradual and sustained reaching a peak of about 11.9 % of GDP by July, 2011, thus exerting considerable pressure on the exchange rate. The widening of the current account emanates from a growing gap between exports and imports of merchandise goods. This mainly reflects the impact of higher prices for oil and chemicals imports.

- 2.4 The committee also observed that domestic demand pressures have also mounted pressure on the current account balance. Domestic demand has been mainly driven by private sector credit expansion as well as increase in public investment in 2010/11. The committee observed that acceleration in private-sector credit growth to about 32% has fueled domestic demand and supported buoyant non-agricultural activity. Credit has grown faster than average for real estate, consumer durables and domestic trade-components that are highly correlated with domestic demand. These developments have been reflected in the deterioration in the current account deficit.
- 2.5 The committee further observed that the volatile situation in Libya and the unrest in other Arab States have seen crude oil prices shoot upwards on the global market- The effect of the rising oil prices has been manifested in a weakening Kenyan shilling. The total cost of fuel rose from 19% to 28% with the pass through effects to domestic prices and to the exchange rate. Thus, a surge in food and fuel price hikes explains most of the recent surge in inflation. Overall inflation reached 17.2 percent in September 2011 while the core inflation that excludes these items from the CPI inflation accelerated to about 8%.
- 2.6 The committee also observed that the euro zone debt crisis especially in Greece, Portugal and Spain has been a factor in the weakening of the Kenya shilling. Fears that the crisis is likely trigger another cycle of global economic meltdown has made investors (local and foreign) sell their securities (shares, bonds) to buy dollars as a relatively safe haven;
- 2.7 The committee observed the depreciation of shilling may have been driven by the sentiments of the financial markets rate - speculators may have read the market and taken the position that the shilling will weaken further thus raising demand for more dollars in order to make a profit.
- 2.8 The committee observed that matters have not been helped by the manner in which the CBK has dealt with the situation. The CBK has blamed commercial banks for speculation on the currency. The commercial banks on the other hand see this blame as unhelpful and illogical since they claim they cannot endanger their sizeable asset books through weakening the shilling for the sake of marginally higher forex earnings. In fact, the commercial banks and other corporate players in the forex markets have blamed the CBK for *lack of policy clarity and consistency*.

### 3. Recommended Measures

The committee observed that whatever decisions the Government makes on this matter, they must be communicated clearly and followed through with speed while observing the spirit and the letter of the constitution as well as the statutes governing institutions such as the CBK. Some of the measures proposed by the committee to be taken may be short term while others may be medium term. The details are as follows:

#### *3.1 Short term Measures*

- 3.1.1 **Promote more effective dialogue between the central bank and the private sector**, more specifically the banks and corporate players in the foreign exchange market and government. The committee observed that credibility is of critical importance on the part of the Bank and that this credibility could be enhanced through engaging in more effective dialogue.
  - 3.1.1.1 **Make decisive actions relating to monetary tightening in order to reign in Inflationary expectations**- Monetary policy needs to ensure that higher growth rates are sustainable by curbing inflation and balance of payments pressures, and by enhancing the central bank international reserve buffer. This entails significantly tightening monetary policy to manage inflation expectations and arrest weakening of the exchange rate. The price to this is to live with a high interest rate policy regime which commercial banks seem ready for. This requires that the CBK sets a CBR rate at least above core inflation and considers accepting higher interest rates for its repo operations- in fact the reverse repos should be equal or higher than the CBR rate. The CRR could also be raised if necessary.
- 3.1.2 **Minimize use of overdraft facility** - In the context of closer monetary-fiscal coordination, the Treasury should attempt to repay in full overdraft liabilities and minimize the use of the central bank overdraft facility. Government borrowing of Ksh 44 billion from the CBK was enormous in just two months (July and August, 2011).
- 3.1.3 **Withdraw the CBK circular to bypass the banking system and deal directly with sellers or buyers of foreign exchange.** The committee observed that implementation of the said circular could lead to rationing of foreign currency, creation of parallel market and multiple currency practices. It could also lead to suspension of the IMF program.
- 3.1.4 **Seek further Financing from the IMF**- While appreciating the US\$508.7 Million under the ECF arrangement provided in December 2010, the US\$200 million under the rapid access component of the Exogenous Shocks Facility (ESF) provided in June 2009 and the US\$350 million provided later in 2009 through the general and special allocations of Special Drawing Rights (SDRs) to all IMF members, the committee augmented BOP support from the Fund be sought.

- 3.1.5 **Make efforts to increase spending capacity of government ministries-** the committee urged the government; in particular ensure that ministries spend to increase absorption of donor funds that in turn will help build up foreign exchange. The absorption rate currently stands at 40-45% and ministries should be made to spend the money without delay.
- 3.1.6 **Address capacity issues in the CBK-** the committee reiterated the need to address capacity issues in the CBK.

### *3.2 Medium term Measures*

- 3.2.1 The Committee called for the implementation of structural policy measures over the medium that that will ensure a low inflation environment and improved competitiveness of the Kenyan economy. The measures can be a combination of policies involving various stake holders. The current policies are facing new challenges and hence there is need to strike a balance between fiscal disciplines, infrastructure spending, and macroeconomic stability. The measures include:
- 3.2.2 **Reduce Fiscal pressures** - Lower spending and lower borrowing requirements over the medium term to minimize pressure on the current account and the exchange rate. Fiscal deficit is now about 7% of GDP and the room for tightening fiscal policy is limited. However, in order to lessen vulnerabilities further, fiscal consolidation should remain a priority to reduce the debt burden below 45 percent of GDP over the medium term. The committee urged for increased implementation of reforms to improve public finance management, maintain a sound financial system, and improve transparency and governance thereby reducing corruption among government entities
- 3.2.3 **Implement Demand policies to narrow the current account deficit.** The committee observed that domestic demand pressures have played a major role in the widening of the external current account deficit. Pressures from domestic demand combined with higher import prices have more than offset higher foreign exchange earnings from traditional and non-traditional sources. Therefore, demand policies should be effective in narrowing the current account deficit over time.
- 3.2.4 **Implementation of more Structural Policies** – the committee observed that policies intended to rein in inflation by increasing food production and reducing over-reliance on fossil fuel-generated power will play a key role in managing the currency which is likely to weaken further. This includes sound agricultural policy that will make Kenya to stop buying more and more maize, rice and wheat from foreigners. The committee in this respect called for improvement of the distribution channels including, for instance, better grain management such as buying surplus from farmers to minimize waste and effective storage to sell in lean times, etc. Fiscal policy measures could also promote rain fed agriculture through irrigation. This entails investing more in water harvesting technique, protection of catchment areas,

riparian's and river rines as well as rehabilitating dams. The committee lauded the unprecedented increase of about kshs 10 billion to the water and irrigation ministries in the 2011/2012 financial and that continued increase of public investments in this sector will address supply side inflation in the medium to long run.

**3.2.5 Seeking more external financing-** Given delay in implementation of significant green energy projects, the need to import oil for thermal power may continue and thus the current account deficit may continue to widen. There is need for foreign financing since domestic financing through the budget cannot finance capital expenditures and food imports. Augment IMF ECF to ease pressure on BOP. This will ease the pressure on official reserves and help build confidence in the forex market. Approach development partners to assist in increasing short term flows, which will ease pressure on official reserves.

**3.2.6 Infrastructure development to address supply side constraints-** The committee called for continued infrastructure development especially that relating to; improved rural access roads, improved rail ways connectivity and management and improved sea ports and airports to elevate Kenya's position as a regional hub for investment and trade. In this respect, the committee also lauded the unprecedented increase of about kshs 65 billion to infrastructure sector ministries in the 2011/2012 financial. The committee observed that continued increase of public investments in this sector will lead to improved distribution channels and reduction in cost of business and thus address supply side inflation in the medium to long run.

#### 4. Members of High Level Committee

High Level Committee Formed By the Prime Minister to Come Up With Comprehensive Measures to Arrest the Sharp Weakening of the Kenya Shilling	
Ministry/ Institution	Members
Office of the Prime Minister	<ol style="list-style-type: none"> <li>1. Dr Mohamed Isahakia (PS)</li> <li>2. Dr Chris Kiptoo (Director, Economic Policy Coordination Unit)</li> <li>3. Prof. Hiroyuki Hino (Economic Advisor)</li> <li>4. Dr Nehemiah Ngeno (Advisor, Government Coordination)</li> </ol>
Office of the President	<ol style="list-style-type: none"> <li>1. Sam Mwale (Principal Administrative Secretary)</li> </ol>
Ministry of Finance/the Treasury	<ol style="list-style-type: none"> <li>1. Mr. Joseph Kinyua (Permanent Secretary)</li> <li>2. Mr. Mutua Kilaka, (Financial Secretary)</li> </ol>

High Level Committee Formed By the Prime Minister to Come Up With Comprehensive Measures to Arrest the Sharp Weakening of the Kenya Shilling

Ministry/ Institution	Members
	<ol style="list-style-type: none"> <li>3. Dr. Kamau Thugge (Senior Advisor)</li> <li>4. Dr. Geoffrey Mwau (Economic Secretary)</li> <li>5. Mr. Henry Rotich (Deputy Director)</li> </ol>
The Central Bank of Kenya	<ol style="list-style-type: none"> <li>1. Prof. Njuguna Ngungu (Governor)</li> <li>2. Mr. Charles Koori (Director of Research)</li> <li>3. Mr. Gerald Nyaoma (Director Financial Markets)</li> </ol>
The Ministry of Planning, National Development and Vision 2030	<ol style="list-style-type: none"> <li>1. Dr Edward Sambili (PS)</li> </ol>
The Vision 2030 Secretariat	<ol style="list-style-type: none"> <li>1. Mugo Kibati (Director General)</li> </ol>
Kenya National Bureau of Statistics	<ol style="list-style-type: none"> <li>2. Mr. Anthony Kilele(Director General)</li> </ol>

Annex 6



OFFICE OF THE PRIME MINISTER  
PERMANENT SECRETARY'S OFFICE

Telegrams "OPM" Nairobi  
Fax No.: +254-(0)20-2210876  
Telephone: +254-(0)20-3247000  
When replying please quote

Office of the Prime Minister  
P. O. BOX 74434-00200  
NAIROBI  
KENYA

Ref No: OPM /1/08/1

31<sup>st</sup> January, 2012

Mr. Patrick G. Gichohi, CBS,  
Clerk of the National Assembly,  
Parliament Buildings,  
PO Box 41842 (00100)  
Nairobi Kenya

**Re: Report of High Level Committee to the Parliamentary Select Committee on the Decline  
of the Kenya Shilling Against Foreign Currencies**

As agreed during our meeting of Wednesday 25<sup>th</sup> January 2012 with the Parliamentary Select Committee on the decline of the Kenya Shilling against foreign currencies, please find attached additional information regarding the work of the high level committee that the Prime Minister constituted in early October 2011 to come up with measures to address the said sharp weakening of the shilling. The Prime Minister constituted the high level committee following advice from the Economic Policy Coordination Unit in OPM (see memo attached here as Annex I dated 28<sup>th</sup> September 2011).

The unit observed that while fundamentals then prevailing in the market accounted for the weakening of the Kenya shilling, the speed and extent of depreciation was a pointer that speculations had crept into the foreign exchange market and that urgent action needed to be taken to arrest the situation. The committee was composed of high level officials from the following institutions: the Central Bank of Kenya (CBK), the Ministry of Finance/the Treasury, the Ministry of Planning, National Development and Vision 2030, The Vision 2030 Secretariat, Kenya National Bureau of Statistics, the Office of the President and the Office of the Prime Minister (OPM).

The committee held at least four meetings and critically looked at both internal and domestic factors causing the shilling. Its report, which is attached hereto as Annex II, observes that lack of

proactive action led to a situation of accelerating inflation, exchange rate depreciation, and rising interest rates, all feeding into each other. On two occasions, the committee invited members of the Kenya Private Sector Alliance (KEPSA) who also presented their positions (Annex III & IV). The committee also held a separate meeting with the members of the Kenya Bankers Association (KBA). It became apparent to the committee that there has been no fruitful dialogue between CBK and the KBA with the latter strongly denying the allegations made by the former that they were engaging in arbitrage and speculative practices in the forex market and thus making supernormal profits at the expense of the common *Mwananchi*. Some members of the KBA attributed the speculative tendencies to lack of policy clarity and consistency by the CBK in its monetary policy actions (see annex V for KBA's report to the select committee).

In subsequent meetings, the high level team held briefing sessions with the Prime Minister who immediately thereafter issued a press release to both the print and electronic media. The statement is attached hereto as annex VI. Having achieved to coordinate all the relevant institutions to come up with measures to deal with the shilling problem, the Prime Minister called for quick implementation of the recommendations. He also agreed to periodically meet with the members of the committee to review progress besides addressing other macroeconomic challenges.

We are happy to note the action taken by the Prime Minister to constitute the committee and thereafter announce the remedial measures helped to calm the markets. The CBK moved quickly to implement the recommendations of the committee. First, it took decisive monetary policy actions as recommended by the committee, the details of which are contained in the attached report (annex VII). The CBK also immediately withdrew its circular to bypass the banking system and deal directly with sellers or buyers of foreign exchange. The committee had observed that the implementation of the said circular could have led to rationing of foreign currency, creation of parallel market and multiple currency practices. It could also have led to suspension of the IMF program.

The OPM is also happy to note that the Ministry of Finance/Treasury also moved with speed to implement short and medium to long-term actions as outlined in the statement by the Deputy Prime Minister and Minister for Finance (annex VIII in addition to their reports already submitted to you). In particular, the Treasury acted quickly to address the problem of inadequate capacity in the CBK by recommending the appointment of a new Deputy Governor to replace the late Dr Hezron Nyangito who had been indisposed for a long time. We are aware also that the Treasury is making efforts to implement the recommended medium and long-term measures to enhance food security.

We are therefore glad to note that our office managed to put up together the high level team that came up with recommendations that greatly helped in stabilizing the shilling. Following the implementation of the measures, the shilling began to strengthen drastically from 107 to 90

against the dollar within five weeks after weakening from 85 to 107 against the green back. We believe that we made a contribution towards restoring stability in the foreign exchange market.

Although our committee sought information on the speculative tendencies witnessed in the foreign exchange market and in particular, the number and identity of banks that traded through the CBK window, that information was not forthcoming. We are therefore glad to note that your select committee, as part of its oversight role of parliament, is focusing on this matter with a view to establishing any malpractices that may have taken place. We hope that the findings of the select committee will greatly complement the work of our office.



Dr. Mohamed Isahakia, CBS

**PERMANENT SECRETARY**



SUBMISSIONS TO THE PARLIAMENTARY SELECT COMMITTEE ON  
THE DECLINE OF THE KENYA SHILLING AGAINST FOREIGN  
CURRENCIES

RESPONSES TO THE QUESTIONS RAISED BY THE PSC  
AT THE MEETING ON  
NOVEMBER 28, 2011 AT 11 A.M.

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Promoting Capital Markets Integrity

## The Mandate and Scope of Responsibility of the Capital Markets Authority (CMA)

The Capital Markets Authority (CMA) was set up in 1989 as a statutory agency under the Capital Markets Act Cap 485A. It is charged with the prime responsibility of regulating, and facilitating the development of an orderly, fair and efficient Capital Markets in Kenya with the view to promoting market integrity and investor confidence.

The regulatory functions of the Authority as provided by the Act and the regulations include; Licensing and supervising all the capital market intermediaries; Ensuring compliance with the legal and regulatory framework by all market participants; Regulating public offers of securities such as equities and bonds and derivatives and the issuance of other capital market products such as collective investment schemes and Asset Backed Securities (ABSs); Promoting market development through research on new products and services; Reviewing the legal framework to respond to market dynamics; Promoting investor education and public awareness and Protecting investors' interest.

CMA's Vision is to be a world-class regulator of a vibrant capital market.

### Background

In addition to factors such as interest rates and inflation, the exchange rate is a key determinant of a country's relative level of economic health. Exchange rates play a vital role in a country's level of trade, which is critical to most free market economies in the world.

The exchange rate of the currency in which capital markets asset portfolios are held impacts that asset portfolio's real return. A declining exchange rate may decrease the purchasing power of any income and capital gains derived from any returns. In addition, where the underlying company invested in relies heavily on imported goods, the declining exchange rate may result in an increase in costs thereby reducing potential profits and the likelihood of the distribution of any income or capital gains on its securities. Moreover, the exchange rate influences other income factors such as interest rates, inflation and even capital gains from domestic securities.

### Responses to Specific questions Raised by The Parliamentary Select Committee on the Decline of the Kenya Shilling Against Foreign Currencies

During the appearance of the Capital Markets Authority before the PSC on the Decline of the Kenya Shilling on November 28, 2011 the Authority was requested to provide available information to support its responses to certain specific questions from the Honourable Members.

Kindly find below, the responses of the Authority and available statistical evidence to support the responses provided to the questions posed:

1. *Has the depreciation of the Kenya shilling affected the capital markets and can the shilling decline be directly attributed to the drop in the NSE index and investment generally?*

i. **Has the KSH depreciation affected Capital Markets?**

YES. In the manner highlighted in (a) and (b) below;

**a. Shilling Depreciation and its effect on listed equities.**

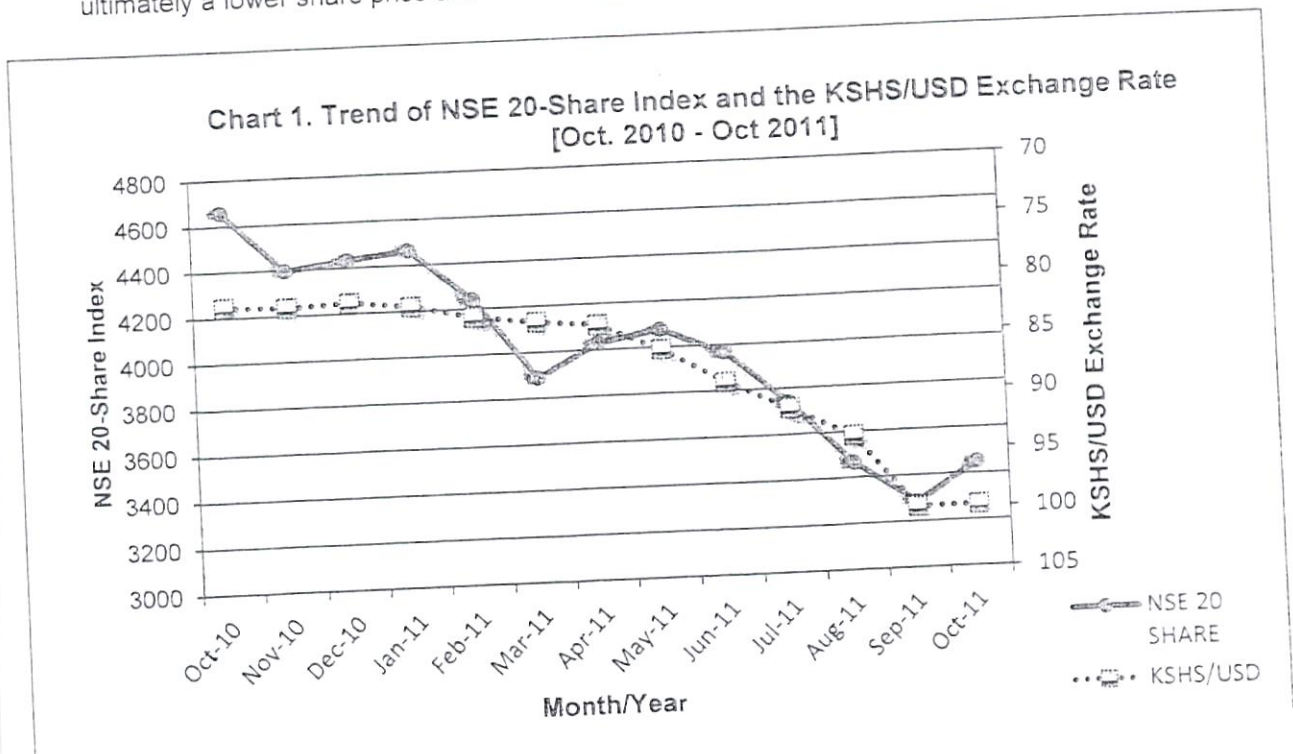
- When the shilling depreciates, the price of imports rises.
- This affects the cost of production of companies (in this case listed companies and those keen on conducting IPOs).
- As a result, earnings projections are revised to reflect the new economic landscape.
- Earnings of listed companies fall, pulling with them investor share demand.
- There are more share sell-offs (therefore higher share supply than demand) leading to share price depression.
- The cycle repeats itself in subsequent shilling depreciation further stoking a bear run. Also, as a result of the bear run companies shy away from conducting IPOs fearing under subscription.

**b. Shilling Depreciation and its effect on bond markets**

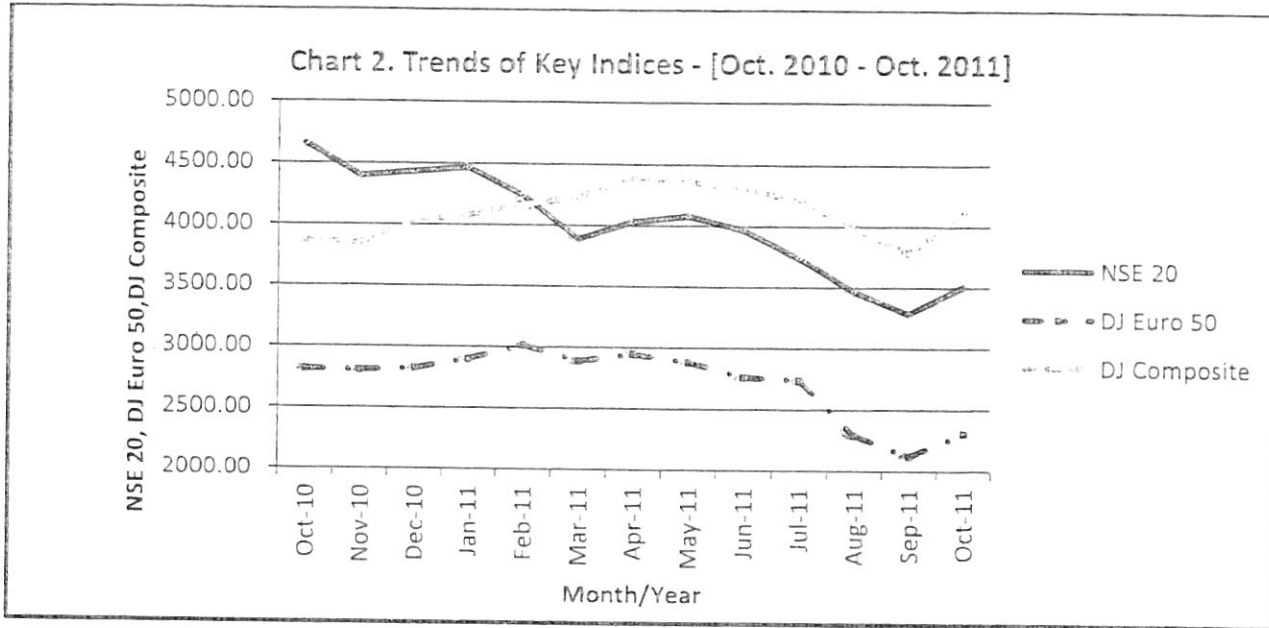
- The depreciation affects yields on already held bonds (by diaspora or foreign investors who have to convert periodic returns from bond investments into their host country's currency).
- It therefore not only leads to lower returns but also discourages further investment in fixed income securities.

**ii. Can the shilling decline be directly attributed to the drop in the NSE index and investment generally?**

- **YES but indirectly**, the shilling depreciation may be partly to blame for the NSE index drop and capital markets investment generally.
- The NSE -20 Share index is computed as a geometric mean of selected twenty companies' share prices. The said companies are regarded as the days 'movers', otherwise referred to as the 'blue chips companies'.
- As chart 1 below shows, there may be a connection between KSH currency changes and stock market index trends. The assumption is, when the shilling depreciates, import prices rise, negatively affecting companies' earnings power, leading to lower company earnings and lower dividends. This leads to a relatively lower view of the affected companies' prospects and ultimately a lower share price and lower share demand relative to supply.



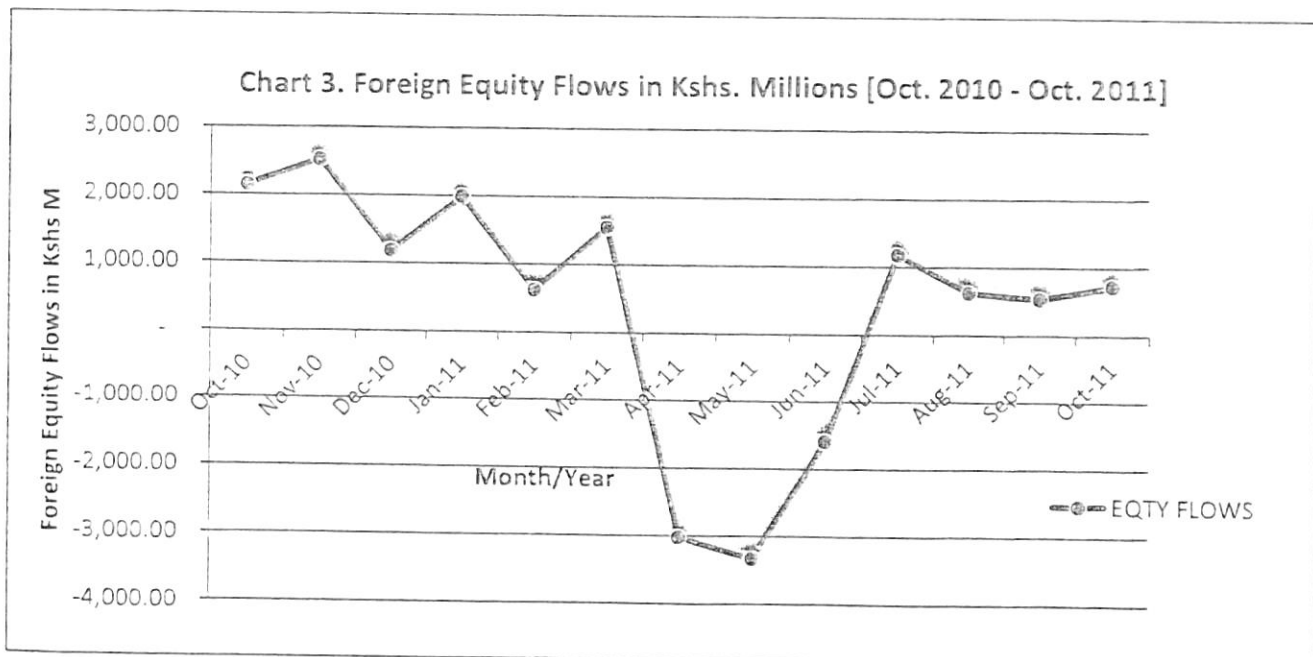
- Also note, the trend in Europe and USA among others has been replicating the movement of the index locally.



Source: CMA

**2. Has there been capital flight and how much is attributed to the depreciation of the Kenya Shilling?**

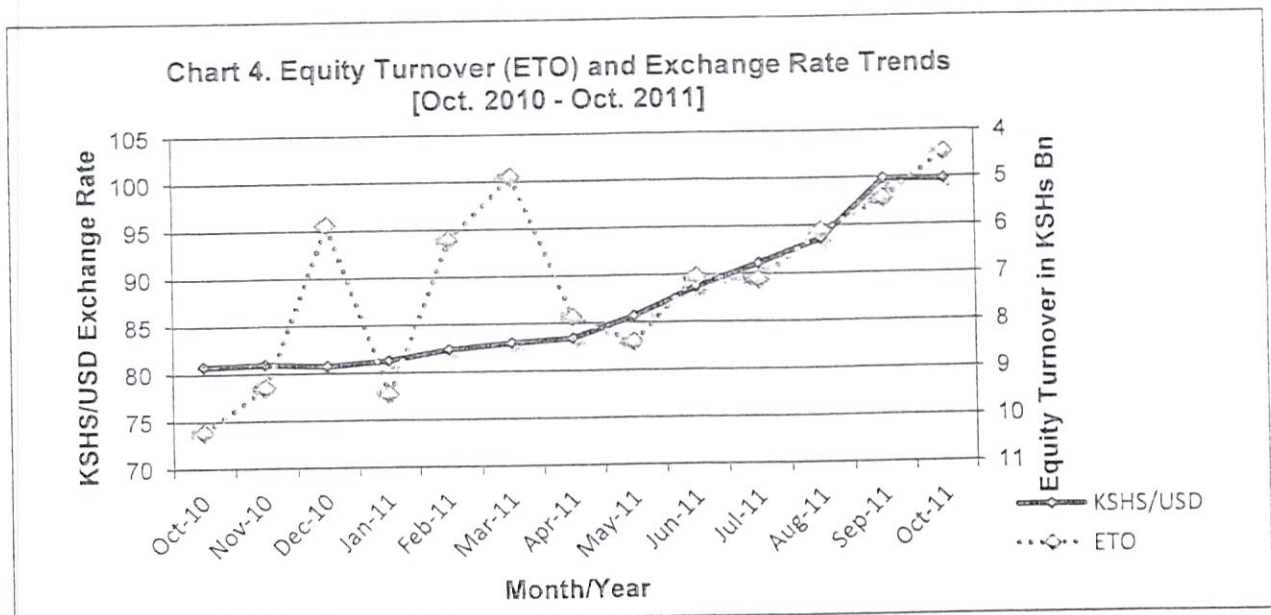
- Capital flight describes the act of investors moving their securities/assets and/or money out of a particular country.



- In the case of Kenya, it cannot be conclusively determined that there has been capital flight from capital markets attributable to the depreciation of the Kenya Shilling.
- More specifically, for the year to date (Oct 2010 – Oct 2011) the total equity fund flows show a net inflow of Kshs. 5.1 billion.
- In addition it may be hypothesized that the funds that flowed out actually returned to some degree given the net positive inflows.

**3. Has the weak shilling resulted in investors selling their shares to survive?**

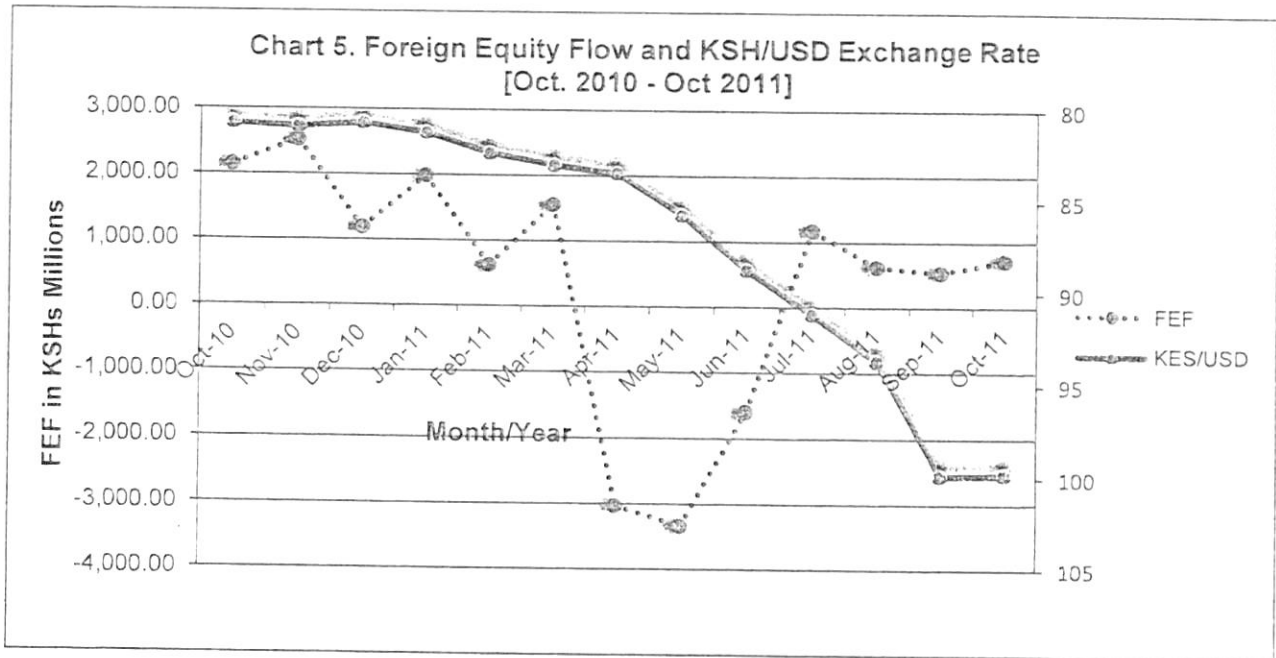
- It may be possible given the increased cost of goods and inflationary pressures, but this is not a matter that the Authority can determine with 100% precision.
- The weaker shilling may have a more significant impact on foreign investors (who are mostly institutions) whose asset valuation declines as a result of exchange rate losses and not local individual (retail) investors.
- A sustained period of depreciation may result in share sales as the listed company may be registering lower earnings resulting in it giving lower dividends. This can depress the company's future prospects and ultimately result in a lower share price and lower share demand relative to supply.



Source: CMA

4. Is there any evidence that amounts of foreign exchange that were being "hoarded" to take advantage of foreign exchange fluctuations were being invested in the capital markets in the interim?

- No. There is no evidence.
- There is no consistent indication of a link between the depreciation of the shilling and net foreign equity flows.
- At the point when the net outflow was highest (Kshs. 3.3bn), the Kenya Shilling was at 85.70 to the USD. As the Kenya shilling continued to depreciate, foreign equity flows did not move in commensurately in the same direction.



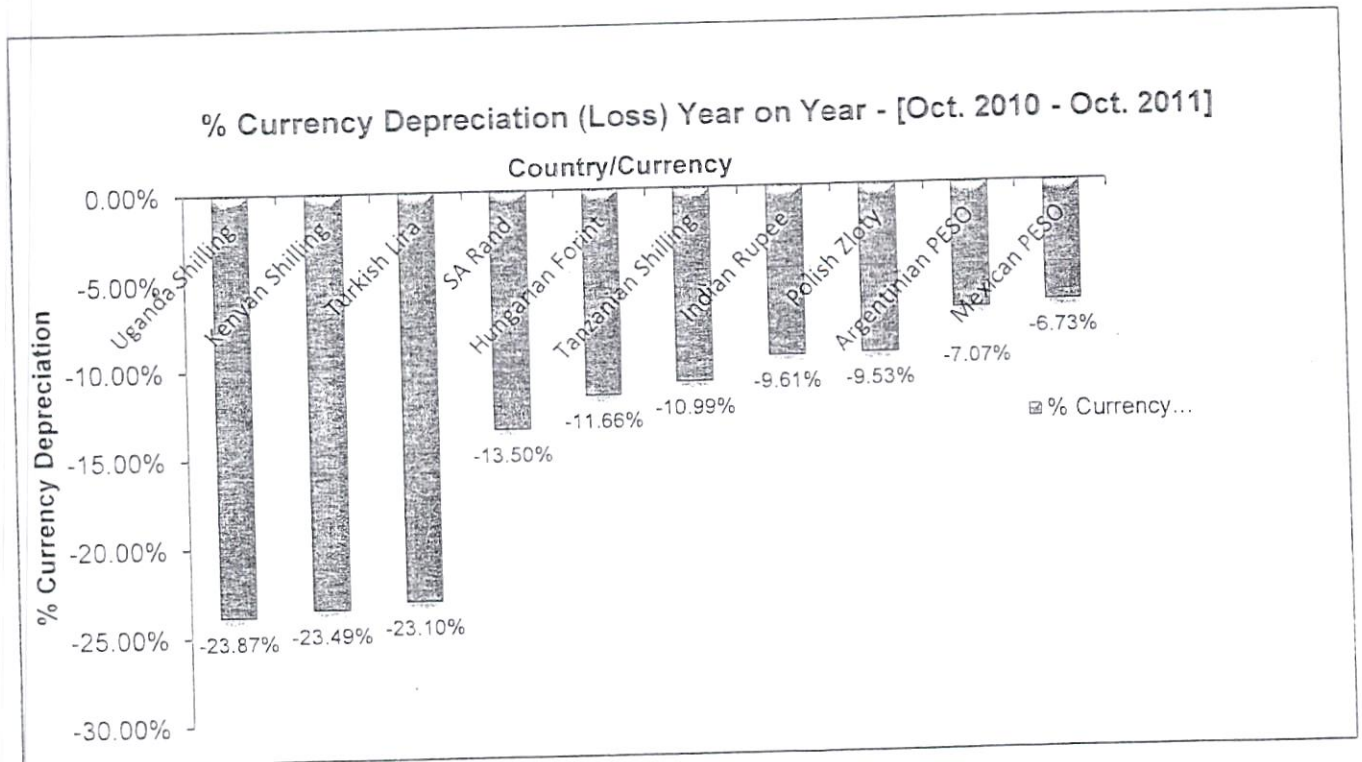
Source: NSE

5. Are there cases of insider dealing that the Authority is investigating or aware of in relation to the depreciation of the Kenya shilling?

The Authority has no indication of any such occurrences.

6. Whether it is true that the weak shilling increases foreign investor flows into the country?

- The current market information does not reflect this. The correlation between the depreciation of the shilling and net foreign equity flows is weak, unpredictable and inconsistent.
- Data indicates that the equity market experienced net foreign equity portfolio outflows when the KSH was relatively stable.
- At the KSH's weakest points, between August and November 2011 the equity market experienced positive (but not the highest) foreign equity portfolio flows.
- It should be noted that foreign investor may dispose of securities for a variety of reasons that are usually strategic and sometimes depend on reporting obligations.
- The loss of value of the Kenya shilling appears to be reflected in a number of other jurisdictions most notably in Uganda and Turkey and South Africa.



Source: CMA



**7. Is the Authority aware of any cartels operating to take advantage of the market for selfish gains? Is there evidence within the capital markets that the depreciation of the shilling was stage managed by such cartels?**

There is no evidence of any such cartels within the regulatory scope of the Authority.

**8. What has CMA done to address the issue since it is affecting investors/ has the Authority raised any red flags?**

The Authority continues to work with the Financial Sector regulators to identify sustainable solutions to the current macro-economic environment.

The Authority has also held stakeholder consultations with its industry participants to chart responses to the current investment environment.

**9. What has CMA done to encourage foreign investors to bring in additional investments to support the foreign exchange reserves?**

- There is no relationship between CMA's mandate and the management of foreign exchange reserves.

**10. Is the Authority aware of cases where investment banks/ portfolio managers have liquidated significant investments in the capital markets in order to transfer the funds to foreign exchange trading activities or banking activities in general?**

The Authority has reviewed the proprietary positions managed by the dealer divisions and there is no indication of any such activity.

**11. Does CMA support the direct increase in interest rates as a solution to the decline in Kenya Shilling?**

It is not within the Authority's mandate to handle monetary and fiscal policy initiatives.

**12. Did CMA provide any advice to Treasury or CBK on the developments during the period of the decline of the Kenya Shilling?**

The Authority maintains open discussions with the Treasury and Central Bank to provide any support to implement policy.

**13. To what extent is the CMA consulted by the Treasury and CBK regarding solutions or measures to address the depreciating shilling and interest rate fluctuations?**

The Authority maintains open discussions with the Treasury and Central Bank to provide any support to implement policy.



**14. Has the decline of the Kenya Shilling slowed down CMA's reform agenda?**

The decline of the Kenyan shilling has cooled investor interest in capital markets products for the reasons detailed here in and has therefore impacted on key reform initiatives targeting:

- Increasing savings rates (combined with inflation pressure purchasing power has declined reducing available income for savings)
- Introducing new products (lower savings for investment as well as high returns available on money market instruments and forex trading shifts attention away from capital markets investment)
- Reduced transaction turn over negatively affects the Authority's and Market Intermediaries revenue streams resulting in budgetary constraints to drive market development initiatives.

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ANNEX 8

161

# EQUITY BANK



Your ref: KNA/PSC.SH.CORR/2012/ (7)

8<sup>th</sup> February 2011

Mr Patrick G. Gichohi  
Clerk of the National Assembly  
Clerk's Chambers  
National Assembly  
Parliament Buildings  
P.O. Box 41842-00100  
Nairobi, Kenya

Dear Sir,

RE: PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST FOREIGN CURRENCIES

We refer to your letter dated 6<sup>th</sup> February 2012 ref: KNA/PSC.SH.CORR/2012/ (7) and the request by the abovementioned committee to avail documents for their consideration.

Kindly find the following documents accompanying this letter.

1. The records of CBK Discount window borrowing for the last 24 months
2. The records of foreign holding for the last 24 months (including FX exposures & FX Loans).

I remain committed to providing full support to the honourable committee in the successful discharge of their mandate.

Yours faithfully,

Dr. James Mwangi, CBS  
Managing Director & CEO

2 x 449



## Foreign Currency Borrowings

DISBURSEMENT	LENDER	MATURITY	RATE	CURRENCY	AMOUNT (USD)
31-May-07	BLUE ORCHARD LOAN FOR DEVELOPMENT	31-May-12	10.29%	USD	(10,000,000.00)
31-May-07	DEUTSCHE BANK	31-Dec-14	11.18%	USD	(7,105,970.00)
29-Jun-07	GROWTH MANAGEMENT LIMITED	29-Jun-12	11.18%	USD	(5,000,000.00)
28-Dec-09	DEXIA MICRO CREDIT FUND	28-Dec-12	3.99%	USD	(5,000,000.00)
6-Jul-10	DEXIA MICRO CREDIT FUND	6-Jul-13	3.81%	USD	(8,000,000.00)
29-Nov-10	CHINA DEVELOPMENT BANK CORPORATION	18-Mar-16	3.13%	USD	(1,500,000.00)
31-May-11	CHINA DEVELOPMENT BANK CORPORATION	18-Mar-16	3.05%	USD	(750,000.00)
11-Aug-11	RESPONSIBILITY	11-Aug-16	4.15%	USD	(15,000,000.00)
1-Sep-11	MICRO-FINANCE ENHANCEMENT FACILITY	1-Sep-14	4.11%	USD	(15,000,000.00)
21-Oct-11	CHINA DEVELOPMENT BANK CORPORATION	18-Mar-16	3.32%	USD	(9,450,000.00)
15-Nov-11	CHINA DEVELOPMENT BANK CORPORATION	18-Mar-16	3.38%	USD	(9,500,000.00)
12-Dec-11	CHINA DEVELOPMENT BANK CORPORATION	18-Mar-16	3.54%	USD	(13,000,000.00)
27-Dec-11	KFWI	13-Dec-18	4.08%	USD	(19,571,940.00)
5-Jan-12	CHINA DEVELOPMENT BANK CORPORATION	18-Mar-16	3.54%	USD	(15,800,000.00)
<b>TOTAL</b>					<b>(134,677,910.00)</b>

Equity Bank has received USD 98 million over the past 9 months from foreign lenders to be used for on lending to borrowers  
This explains the rise in our FX holdings over the period

### LOAN DISBURSEMENTS

KPLC	USD 62.5million
Jetlink	USD 8.4 million
African Gas and Oil	USD 15million

FOREIGN CURRENCY HOLDINGS 2011

CURRENCY	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
1. US DOLLAR	26,891,514.08	25,295,223.91	17,179,837.56	8,958,088.77	18,654,695.40	11,713,740.79	16,576,061.20	17,681,809.84	42,092,814.22	25,230,574.46	4,831,529.14	44,292,532.18
2. STERLING POUND	447,260.95	743,531.46	917,301.67	750,556.91	745,633.16	973,140.66	922,036.01	291,487.58	652,744.92	774,746.92	812,880.60	724,811.13
3. EURO	2,714,790.79	3,104,846.65	2,488,859.47	3,361,633.25	3,164,502.74	2,326,404.42	2,237,494.37	2,374,616.63	2,723,191.27	4,106,337.47	3,489,371.93	3,929,074.69
4. SWISS FRANK	(3,704.03)	202,495.95	182,766.34	170,430.30	181,847.20	198,084.22	234,179.71	191,598.75	250,238.90	272,254.56	238,060.33	209,450.00
5. CANADIAN DOLLAR	45,845.38	36,547.83	65,831.43	33,252.53	31,919.93	63,845.77	27,620.51	36,982.28	54,369.04	57,416.17	74,687.58	73,412.01
6. JAPANESE YEN	(4,499,614.00)	16,334,391.20	12,168,317.20	8,326,705.20	16,605,080.78	14,780,230.20	15,794,041.20	16,396,642.20	(228,016,500.50)	30,806,344.20	36,050,657.20	34,330,551.20
7. NORWEGIAN KRONERS	197,232.51	197,232.51	197,232.51	312,340.55	314,123.31	353,968.95	394,424.74	394,424.74	452,919.45	616,650.31	715,128.31	722,498.70
8. DANISH KRONERS	(310,532.50)	514,471.26	467,932.66	474,711.07	504,313.27	0.00	503,994.21	523,812.06	539,666.01	622,347.99	627,573.31	640,564.23
9. S. AFRICAN RAND	1,168,325.90	1,250,220.41	1,352,868.89	1,094,481.74	1,310,321.16	1,479,757.94	1,261,686.86	701,020.93	1,517,729.26	1,289,668.34	2,037,142.27	1,045,455.35
10. AUSTRALIA DOLLAR	24,650.23	25,317.44	130,752.73	110,300.41	99,611.08	86,569.18	112,862.37	101,860.22	105,041.95	99,042.16	80,022.31	99,092.16
11. UGANDAN SHILLING	495,000,000.00	462,440,000.00	1,443,396,079.81	1,443,396,079.81	1,443,393,079.81	1,804,670,117.24	1,804,670,117.24	1,691,316,595.03	1,196,890,846.55	1,972,866,999.97	1,939,139,713.77	1,867,331,166.57
12. SUDANESE POUND	2,499.51	2,499.51	(473,157.50)	(2,825,428.17)	(3,277,420.95)	(2,842,741.65)	(5,276,466.03)	(4,564,161.97)	12,109,193.05	12,483,054.24	12,424,678.41	392,580.62
13. SWEDISH KRONA	(220,889.17)	161,330.16	330,856.21	347,086.36	347,086.36	377,650.15	273,825.71	282,654.35	319,109.39	447,769.66	483,963.48	463,963.48
TOTAL (USD EQUIVALENT)	31,837,061,176.82	31,766,132,921.82	23,469,007,861.82	16,219,840.36	24,657,161,431.82	17,163,396,201.82	20,967,760,161.82	21,654,889,431.82	49,984,739,330.82	36,313,467,230.82	16,313,778,710.82	66,891,099,060.82

FOREIGN CURRENCY HOLDINGS 2012

CURRENCY	JAN
1. US DOLLAR	62,418,096.35
2. STERLING POUND	664,735.66
3. EURO	3,451,898.85
4. SWISS FRANK	204,607.77
5. CANADIAN DOLLAR	71,083.97
6. JAPANESE YEN	35,310,764.20
7. NORWEGIAN KRONERS	856,048.40
8. DANISH KRONERS	670,665.86
9. INDIAN RUPEE	0.00
10. S. AFRICAN RAND	1,560,779.18
11. AUSTRALIA DOLLAR	96,074.57
12. UGANDAN SHILLING	1,813,469,524.38
13. TANZANIA SHILLING	0.00
14. SUDANESE POUND	12,849,246.86
15. SWEDISH KRONA	432,063.66
TOTAL (USD EQUIVALENT)	74,470,832.32

FOREIGN CURRENCY HOLDINGS 2010

CURRENCY	MONTH	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
1. US DOLLAR	USD	6,810,151.00	6,848,433.62	8,038,684.81	10,081,261.05	8,036,482.62	11,319,142.69	11,807,762.51	3,067,246.24	16,531,426.95	24,605,482.18	21,455,935.81	25,402,750.11
2. BRITISH POUND	GBP	608,163.17	533,742.62	2,086,594.83	1,681,651.25	1,447,813.75	1,646,441.80	2,077,119.09	2,813,884.15	2,765,370.70	1,907,838.52	2,325,002.23	3,897,472.62
3. EURO	EUR	1,505,372.72	2,019,595.73	2,028,502.03	1,938,055.79	1,547,448.17	1,646,441.80	2,077,119.09	2,813,884.15	2,765,370.70	1,907,838.52	2,325,002.23	3,897,472.62
4. SWISS FRANK	CHF	-116,237.87	81,036.71	90,461.66	85,921.67	138,810.66	116,563.27	146,310.36	151,300.30	100,807.08	67,271.27	131,609.40	109,072.96
5. CANADIAN DOLLAR	CAD	49,603.44	42,542.11	30,723.51	48,657.24	22,760.74	25,889.81	45,480.19	19,415.19	42,055.73	25,673.91	27,287.87	37,634.16
6. JAPANESE YEN	JPY	16,545,681.24	17,511,894.24	13,079,538.94	15,965,821.74	16,480,366.57	20,151,277.65	12,458,916.25	11,912,411.19	15,632,777.20	15,258,531.20	13,519,974.20	12,798,882.20
7. NORWEGIAN KRONERS	NOK	59,132.14	81,132.14	44,748.27	44,560.50	24,797.65	16,812.26	54,812.26	19,373.26	169,215.32	174,215.32	192,981.58	162,981.58
8. DANISH KRONERS	DKK	275,332.28	276,948.85	306,051.30	357,846.33	398,536.33	405,784.97	374,507.31	370,860.45	315,244.14	316,539.17	272,994.23	240,906.05
9. INDIAN RUPEE	INR	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10. SOUTH AFRICAN RAND	ZAR	792,112.37	1,206,659.52	1,714,412.86	1,333,228.58	1,420,839.36	1,605,858.19	1,411,663.89	601,841.06	1,530,189.71	918,630.43	1,515,174.33	258,974.23
11. AUSTRALIAN DOLLAR	AUD	68,310.00	149,000.00	198,000.00	82,000.00	91,000.00	32,250.00	34,600.00	37,500.00	87,500.00	104,800.00	81,200.00	117,700.00
12. UGANDIAN SHILLING	UGX	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
13. TANZANIAN SHILLING	TZS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
14. SUDANESE POUND	SDS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
15. SWEDISH KRONA	SEK	45,821.09	45,621.09	55,660.65	45,597.63	38,273.09	68,491.95	71,331.09	73,867.93	68,488.43	73,411.05	85,346.52	161,204.43
TOTAL (USD EQUIVALENT)	USD	10,340,710.46	11,391,414.03	13,373,123.81	14,806,080.53	11,835,769.35	15,181,042.44	15,754,960.52	9,478,771.41	21,850,984.64	47,351,302.18	26,673,889.81	35,411,455.67

FOREIGN EXPOSURE

MONTH	NET OPEN POSITION (A-L)	LONG Position (where A - L is +ve)	SHORT Position (where A - L is -ve)
JAN	-308,144.00	546,553.00	-854,697.00
MAR	-797,351.00	589,926.00	-1,387,277.00
JUN	-664,265.00	443,917.00	-1,108,182.00
SEP	-873,349.00	517,648.00	-1,390,997.00
DEC	-462,322.00	483,088.00	-945,410.00

A-Total Foreign Assets

L-Total Foreign Liabilities





KCB

Making the  
Difference

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16<sup>th</sup> December, 2011.

Mr. Patrick G. Gichohi, CBS  
Clerk of the National Assembly,  
NAIROBI

Dear Sir,

**REPORT FOR ATTENTION OF CHAIRMAN PARLIAMENTARY SELECT  
COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST FOREIGN  
CURRENCIES**

Following your letter Reference KNA/PSC.SH/CORR/2011/(26) of 7<sup>th</sup> December, 2011 and the subsequent meeting with your Committee on 14<sup>th</sup> December, 2011, we submit herewith a Report addressing the issues raised in the format requested.

Please acknowledge receipt on the extra copy of this letter.

Yours faithfully,

  
PAUL MWANGI  
CHIEF OPERATING OFFICER

c.c. Hon. Adan Keynan,  
Chairman, Parliamentary Select Committee on  
Decline of Kenya Shilling  
NAIROBI.

Directors: P.W. Muthoka; (Chairman); Dr. M.L. Oduor-Otieno (Chief Executive); J.K. Kinyua;  
Mrs. S.N. Omanga; Mrs. C.A. Kola; S.N. Shah; J. Adongo; Prof. P.K. Kimuyu; Eng. J.M. Ndeto; Ng'eny Biwott

  
16/12



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KCB Difference

Kenya Commercial Bank Limited

Chief Operating Officer

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Email: [piikani@kcb.co.ke](mailto:piikani@kcb.co.ke)

Website: <http://www.kcbbankgroup.com>

Discussion on the decline of Kenya Shilling at the Parliamentary Select Committee by KCB on 14<sup>th</sup> December 2011.

(a) Causes of exchange rate depreciation:

- Political crisis in North Africa and Middle East resulted in oil prices going up from \$80 per barrel to \$120 per barrel thereby putting more strain on balance of payments and foreign currency requirements to pay for oil imports as consumption remained the same even with rising prices
- Disruption at the tea auction as Egypt which buys 30% of Kenya's tea stayed out of the auction and tea remained unsold thereby reducing the foreign exchange coming into the market.
- There was a sell-off in the equities market globally and especially affecting emerging and frontier markets. This resulted in lower foreign participation in the NSE and saw some pulling out of market thereby putting more pressure on the Kenya Shilling as the investors bought foreign currency.
- CBR rate cut earlier in the year to a low of 5.75% as inflation was looking up with commodity prices having gone up globally. This made it cheaper to borrow Kenya Shillings to drive economic expansion.
- Drought in Kenya which meant more food imports coupled with switching over to diesel generators for power production increased pressure on Kenya shilling as USD demand increased to pay for food and oil.

(b) Measures KCB took to deal with above and quantifiable impact:

- KCB took a very risk averse position and internal limits on trading desk were limited to 10% of core capital instead of the statutory limit of 20%.
- Actual usage of those limits was around the 3% of core capital.
- It is difficult to quantify the impact of this risk averse position.

**Directors:** P.W. Muthoka; (Chairman); Dr. M.L. Oduor-Otieno (Chief Executive); J.K. Kinyua;  
Mrs. S.N. Omanga; Mrs. C.A. Kola; S.N. Shah; J. Adongo; Prof. P.K. Kimuyu; Eng. J.M. Ndeti; Ng'eny Biwott

(c) Data requested:

MONTH 2011	Foreign Currency Reserves (USD)	FX volumes (USD)	FX trading profit & loss (KES)
January	61,257,488/=	903,849,765.06	117,695,814.13
February	60,017,622/=	796,307,609.84	110,992,186.70
March	80,798,121/=	1,001,419,089.87	160,900,746.55
April	47,210,210/=	1,129,828,629.25	121,775,667.62
May	39,314,562/=	1,345,227,232.40	126,106,987.27
June	37,368,705/=	934,468,110.03	132,171,992.64
July	37,486,676/=	930,910,971.55	179,791,433.53
August	39,773,711/=	829,863,694.95	118,330,047.51
September	86,677,012/=	700,848,493.10	230,237,540.84
October	94,087,350/=	560,582,540.50	
November	85,280,861/=	634,984,788.95	
TOTAL			1,298,002,416.79

(d) Months of import cover KCB is holding:

Unfortunately not monitored by bank as balances are client money and not proprietary bank holdings.

(e) Impact of increase in CRR:

1) Increased volatility in interest rates which saw short term rates edge up with the overnight interbank rates touching a high of 30% as a results.

x  
~~2) Wholesale deposit rates also shot up making the cost of funds for banks higher.~~

- 3) Treasury bill rates have also edged up as the market experienced tight liquidity conditions.
- 4) Increase in the lending rates to an average of about 24% as cost of funding soared.
- 5) Negative impact on economic growth as cost of credit rises and availability of funds to the productive sector.
- 6) Expected increase in loan defaults.
- 7) On positive side, the shilling gained against the dollar and reversed its depreciating trend.

**PAUL TIKANI**  
**CHIEF OPERATING OFFICER**

Discussion on the decline of Kenya Shilling at the Parliamentary Select Committee by KCB on 14<sup>th</sup> December 2011.

(a) Causes of exchange rate depreciation:

- Political crisis in North Africa and Middle East resulted in oil prices going up from \$80 per barrel to \$120 per barrel thereby putting more strain on balance of payments and foreign currency requirements to pay for oil imports as consumption remained the same even with rising prices
- Disruption at the tea auction as Egypt which buys 30% of Kenya's tea stayed out of the auction and tea remained unsold thereby reducing the foreign exchange coming into the market.
- There was a sell-off in the equities market globally and especially affecting emerging and frontier markets. This resulted in lower foreign participation in the NSE and saw some pulling out of market thereby putting more pressure on the Kenya Shilling as the investors bought foreign currency.
- CBR rate cut earlier in the year to a low of 5.75% as inflation was looking up with commodity prices having gone up globally. This made it cheaper to borrow Kenya Shillings to drive economic expansion.
- Drought in Kenya which meant more food imports coupled with switching over to diesel generators for power production increased pressure on Kenya shilling as USD demand increased to pay for food and oil.

(b) Measures KCB took to deal with above and quantifiable impact:

- KCB took a very risk averse position and internal limits on trading desk were limited to 10% of core capital instead of the statutory limit of 20%.
- Actual usage of those limits was around the 3% of core capital.
- It is difficult to quantify the impact of this risk averse position.

**(c) Foreign reserves held by the bank:**

Jan 2011-	USD 61,257,488/=
Feb 2011-	USD 60,017,622/=
Mar 2011-	USD 80,798,121/=
Apr 2011-	USD 47,210,210/=
May 2011-	USD 39,314,562/=
Jun 2011 -	USD 37,368,705/=
July 2011 -	USD 37,486,676/=
August 2011 -	USD 39,773,711/=
Sept 2011 -	USD 86,677,012/=
Oct 2011 -	USD 94,087,350/=
Nov 2011-	USD 85,280,861/=

**(d) Months of import cover KCB is holding:**

Unfortunately not monitored by bank as balances are client money and not proprietary bank holdings.

**(e) Impact of increase in CRR:**

- 1) Increased volatility in interest rates which saw short term rates edge up with the overnight interbank rates touching a high of 30% as a results in mid-November from 6.5% average in September .
- 2) Whole sale deposit rates also shot up making the cost of funds for banks higher. The average rates on whole sale deposits stood at 10% in July, 15% in September and 25% in November on average. Retail deposit rates equally moved up in similar way to high of 18% in November.
- 3) Treasury bill rates have also edged up as the market experienced tight liquidity conditions. The 91 day TB moved from 9% in June, 13% in September and averaged at about 16% in November.
- 4) Increase in the lending rates to an average of about 24% in November from average of 14% in July as cost of funding soared.

- 5) Negative impact on economic growth as cost of credit rises and availability of funds to the productive sector.
- 6) Expected increase in loan defaults.
- 7) On positive side, the shilling gained against the dollar and reversed its depreciating trend.

  
C. O. O.  
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February 10, 2012

**Mr. Patrick G. Gichohi, CBS**  
Clerk of the National Assembly  
Clerk's Chambers  
National Assembly  
Parliament Buildings  
Parliament Road  
**NAIROBI**

Dear *Mr. Gichohi,*

**RE: PARLIAMENTARY SELECT COMMITTEE ON THE DECLINE OF THE KENYA SHILLING AGAINST FOREIGN CURRENCIES**

Reference is made to your letter dated 6 February 2012 regarding the above subject matter.

Please find enclosed the 2 reports showing the following records that were requested by the select committee;

- 1) The records of CBK window borrowing for the last 24 months.
- 2) The records of the foreign money holding for the last 24 months.

Yours sincerely,

**DR. MARTIN ODUOR-OTIENO, CBS**  
**CHIEF EXECUTIVE**

**KENYA COMMERCIAL BANK LIMITED**  
**REPORT ON CBK WINDOW BORROWING FOR 24 MONTHS**  
**REPORT SHOWS BORROWINGS PER DAY**

DEAL DATE	MATURITY DATE	AMOUNT KSHS
7-Jun-10	8-Jun-10	160,000,000
10-Jun-10	11-Jun-10	2,200,000,000
19-Oct-10	21-Oct-10	800,000,000
20-Apr-11	21-Apr-12	550,000,000
4-May-11	5-May-11	900,000,000
6-May-11	9-May-11	650,000,000
19-May-11	20-May-11	1,300,000,000
31-May-11	2-Jun-11	1,400,000,000
7-Jun-11	8-Jun-11	1,000,000,000
8-Jun-11	9-Jun-11	2,300,000,000
9-Jun-11	10-Jun-11	600,000,000
10-Jun-11	13-Jun-11	2,200,000,000
13-Jun-11	14-Jun-11	6,040,000,000
14-Jun-11	15-Jun-11	5,640,000,000
15-Jun-11	16-Jun-11	4,480,000,000
16-Jun-11	17-Jun-11	2,640,000,000
17-Jun-11	20-Jun-11	7,580,000,000
20-Jun-11	21-Jun-11	5,840,000,000
21-Jun-11	22-Jun-11	5,440,000,000
22-Jun-11	23-Jun-11	5,940,000,000
23-Jun-11	24-Jun-11	3,264,000,000
24-Jun-11	27-Jun-11	1,264,000,000
27-Jun-11	28-Jun-11	3,640,000,000
28-Jun-11	29-Jun-11	4,240,000,000
29-Jun-11	30-Jun-11	3,340,000,000
30-Jun-11	1-Jul-11	6,880,000,000
1-Jul-11	4-Jul-11	6,040,000,000
4-Jul-11	5-Jul-11	6,580,000,000
5-Jul-11	6-Jul-11	5,640,000,000
6-Jul-11	7-Jul-11	3,740,000,000
7-Jul-11	8-Jul-11	3,840,000,000
8-Jul-11	11-Jul-11	5,840,000,000
11-Jul-11	12-Jul-11	2,000,000,000
12-Jul-11	13-Jul-11	3,340,000,000
15-Jul-11	18-Jul-11	2,000,000,000
18-Oct-11	19-Oct-11	6,080,000,000
19-Oct-11	21-Oct-11	4,240,000,000
21-Oct-11	24-Oct-11	4,480,000,000
24-Oct-11	25-Oct-11	2,000,000,000
26-Oct-11	27-Oct-11	2,640,000,000
27-Oct-11	28-Oct-11	1,800,000,000
28-Oct-11	31-Oct-11	1,000,000,000
18-Nov-11	21-Nov-11	1,840,000,000

KENYA COMMERCIAL BANK LIMITED  
MONTHLY FOREIGN CURRENCY HOLDINGS FOR 24 MONTHS  
REPORT CONTAINS BOTH FOREIGN ASSETS AND FOREIGN LIABILITIES

Month	Foreign Assets	Foreign Liabilities
2010	in KES '000	in KES '000
January	27,239,167	16,442,130
February	30,178,184	19,175,369
March	30,601,063	16,353,708
April	29,142,776	19,954,421
May	30,142,747	20,031,038
June	29,957,471	18,205,233
July	29,773,210	18,427,756
August	30,125,353	19,802,022
September	33,661,753	21,819,747
October	32,971,171	23,859,647
November	32,634,816	15,935,514
December	33,592,037	19,273,025
Month	Foreign Assets	Foreign Liabilities
2011	KES '000	KES '000
January	36,089,292	16,501,668
February	36,667,283	23,890,756
March	38,143,333	18,870,855
April	37,240,145	27,565,993
May	39,658,124	22,573,322
June	42,834,807	20,199,504
July	44,006,362	30,383,782
August	48,124,696	14,173,004
September	57,476,699	39,574,857
October	56,505,442	44,795,144
November	53,939,303	40,498,615
December	56,476,069	49,590,368

ANNEX 10



**PRESENTATION TO THE PARLIAMENTARY SELECT  
COMMITTEE ON THE DECLINE OF THE KENYA SHILLING  
AGAINST FOREIGN CURRENCIES**

10<sup>th</sup> February 2012

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## I. BACKGROUND

- Mr. Chairman, on 14<sup>th</sup> December 2011, we had an opportunity to appear before this Parliamentary Select Committee on the decline of the Kenya Shilling against foreign currencies and we shared our views on circumstances leading to the weakening of the shilling in early October 2011.
- In our formal presentation, we highlighted the causes of the Exchange rate depreciation against the foreign currencies, impact of the increase of the Central Bank Rate (CBR) to 18% to the general growth of the economy, Co-operative Bank's experience and overall performance of CBK and recommendations on prudent management of foreign exchange.
- On 26<sup>th</sup> January, we had another opportunity to appear before the Committee following a request dated 19<sup>th</sup> January 2012, to provide further information regarding actions taken by CBK on our bank in regard to our Bank's foreign exchange trading activities, the use of the CBK Discount window and participation in the interbank market.
- Mr. Chairman, we informed this committee that we did not receive any warning letter from the Central bank of Kenya, nor did we receive any suspension from the Central Bank in regard to participating in foreign exchange market, use of the discount window of the Central Bank of Kenya and in participation in the interbank lending market.
- Mr. Chairman, we emphasised that our bank did not engage in any irregular activities, with or without any borrowings from the Central Bank of Kenya.

## II. CBK DISCOUNT WINDOW BORROWING AND FOREIGN MONEY HOLDING

Mr. Chairman, in terms of your request for the above records, we forward herewith the following:-

Appendix 1: The records of CBK discount window borrowing for the last 24 months

Appendix 2: The records of foreign money holding for the last 24 months

## Key Highlights

In regard to the borrowing from CBK Discount Window for the last 24 months, I would like to make the following comments;-

- Central Bank lending to commercial banks through the discount window is strictly on overnight basis only and banks normally use the facility if they are not able to cover their deficit in the interbank market.
- Borrowing from CBK discount window is normally more expensive than borrowing from the interbank market and banks therefore go to the discount window as a last resort.
- When the Monetary Policy Committee tightened the monetary policy from 22<sup>nd</sup> March 2011, the market suffered severe liquidity crunch which persisted until the end of year. This is the period that our borrowing from the Central Bank discount window was relatively higher. Our borrowing from the window was therefore occasioned by our need for Kenya Shilling funding and our inability to satisfy our needs from the market.
- During the period of tight monetary policy, Secondary market trading in Treasury Bonds dropped considerably and liquidating of the securities became difficult.
- Mr. Chairman, in spite of the difficulties experienced during the period, we took actions that enabled us reduce our funding gap and by December, we had completely stopped borrowing from the discount window. Amongst some of the actions we took included rediscounting some of our securities, squeezing our credit growth and aggressive mobilization of deposits.
- Mr. Chairman, it is worth noting that our liquidity ratio which we had maintained at around 40% before the liquidity crunch, dropped to less than 30% due to some of the actions highlighted above.

In regard to the foreign money holding for the last 24 months, I would like to make the following comments;


- Mr. Chairman, I would like to highlight that our borrowing from the Central Bank does not show any correlation with our holdings in foreign currency. For instance, in the month of April 2011, we borrowed on

average Kes 1.04 billion per day, which was relatively higher than the previous month, but our FX holdings dropped from Kes 16.68 billion to 14.75 billion. Similarly Mr. Chairman, in June when we borrowed the highest amount from CBK discount window, our FX holdings were largely unchanged from the previous month.

- Mr. Chairman, I wish to emphasise that our bank did not borrow from the Central Bank discount window for a period of six weeks prior to the depreciation of the shilling in early October 2011.
- Further Mr. Chairman, I wish to point out that Co-operative Bank is a responsible citizen and we have prudently operated within set guidelines and legal framework. For instance, even when the Foreign Exchange exposure was at 20% (before it was reviewed to 10% to suppress opportunities for possible irregular tendencies), we have always operated within an internal limit of 3.50%.

### III. OTHER POINTS TO CONSIDER

- Mr. Chairman, as pointed out above, Central Bank's lending to commercial banks through the Discount window is strictly on overnight basis only. It would therefore not be prudent for a bank to speculate with foreign currency exposure for a long period, spanning several weeks or months, using funds that are only available on overnight basis.
- The shilling interest rates went as high as 30.00% by October and any act of speculation would therefore have been rendered infeasible and the foreign currency held for speculation purposes would have been offloaded in the market.

  
Dr. Gideon Muriuki - MBS  
Group Managing Director & CEO

Appendix 1: Record of CBK Discount Window Borrowing for the last 24 months

BORROWINGS FROM CENTRAL BANK OF KENYA DISCOUNT WINDOW		
MONTH	DW BORROWING PER MONTH - AMOUNT KSHS('000)	DW AVERAGE BORROWING PER DAY (KES ('000))
Jan-10	79,000	2,548
Feb-10	-	-
Mar-10	900,000	29,032
Apr-10	-	-
May-10	-	-
Jun-10	-	-
Jul-10	-	-
Aug-10	1,317,000	42,484
Sep-10	-	-
Oct-10	-	-
Nov-10	-	-
Dec-10	-	-
<b>TOTAL</b>	<b>2,296,000</b>	<b>6,290</b>
Jan-11	-	-
Feb-11	-	-
Mar-11	360,000	11,613
Apr-11	31,330,000	1,044,333
May-11	7,410,000	239,032
Jun-11	78,626,000	2,620,867
Jul-11	34,795,000	1,122,419
Aug-11	6,960,000	224,516
Sep-11	-	-
Oct-11	16,000,000	516,129
Nov-11	11,000,000	366,667
Dec-11	-	-
<b>TOTAL</b>	<b>186,481,000</b>	<b>510,907</b>
<b>GRAND TOTAL</b>	<b>188,777,000</b>	<b>258,599</b>

- Column 2 shows the aggregate monthly borrowing while column 3 shows the average daily borrowing.

## Appendix 2: Record of foreign money holding for the last 24 months

FOREIGN CURRENCY HOLDINGS		
MONTH	AMOUNT (USD '000)	AMOUNT (KSHS '000)
Jan-10	79,247.63	6,013,754.00
Feb-10	110,319.30	8,451,396.00
Mar-10	111,411.94	8,615,641.00
Apr-10	117,833.17	9,104,497.00
May-10	117,327.52	9,356,318.00
Jun-10	142,034.68	11,635,012.00
Jul-10	185,920.18	14,916,320.00
Aug-10	158,341.79	12,836,943.00
Sep-10	106,158.83	8,575,309.00
Oct-10	121,845.43	9,843,514.00
Nov-10	128,145.54	10,376,483.00
Dec-10	160,024.77	12,922,304.00
Jan-11	134,851.53	10,959,680.00
Feb-11	172,339.08	14,194,519.00
Mar-11	201,045.87	16,684,576.00
Apr-11	176,796.12	14,748,226.00
May-11	139,098.58	11,921,360.00
Jun-11	136,943.48	12,306,275.00
Jul-11	141,927.11	12,929,559.00
Aug-11	147,438.59	13,803,526.00
Sep-11	139,005.19	13,877,152.00
Oct-11	170,854.87	17,047,609.00
Nov-11	151,364.50	13,580,544.00
Dec-11	172,542.15	14,677,833.00

- Column 2 shows the holdings in US Dollar terms while column 3 shows the equivalent in Kenya shillings converted at the CBK mean rate at the end of the corresponding month.
- Our holdings in October when the shilling was at its lowest is comparable to our holdings in February, April and December and lower than our holdings in March and is therefore within reasonable balances held in the course of normal business.

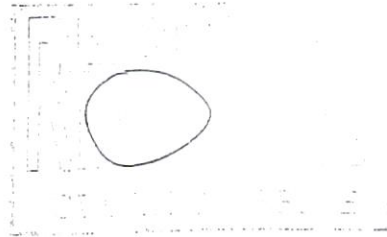


**KENYA CO-OPERATIVE COFFEE EXPORTERS**

5<sup>th</sup> Floor, Co-operative Bank House, Haile Selassie Avenue  
P.O. Box 54980 - 00200,  
Nairobi

03 February 2012

Mr. Patrick G. Gichohi - CBS,  
Clerk of the National Assembly,  
Parliament Buildings,  
P. O. Box 41842 -00100  
NAIROBI



Dear Sir,

RE: PARLIAMENTARY SELECT COMMITTEE ON THE DEPRECIATION OF THE  
KENYA SHILLING

We kindly refer to an article in the Sunday Nation newspaper of 29<sup>th</sup> January 2012, page 34, that gave highlights on matters discussed at the above referenced Committee where Kenya Co-operative Coffee Exporters (KCCE) was adversely mentioned and wish to clarify facts about KCCE.

**a) Registration and Licensing of KCCE**

The establishment of Kenya Co-operative Coffee Exporters Limited (KCCE) was a smallholder coffee farmer initiative through the Ministry of Co-operative Development and Marketing with the principal objective of addressing the plight of the small holder coffee farmer.

Kenya Co-operative Coffee Exporters Society Ltd (KCCE) was registered on 25<sup>th</sup> June 2009 under the Co-operative Societies Act by coffee co-operative societies/Unions and thereafter licensed as a commercial marketing agent by Coffee Board of Kenya. The initiative brought together key Co-operative Societies in the coffee industry, and the apex organisations in the sector.

The main objective of KCCE was to promote, organise and undertake the marketing of coffee in the local and export markets in order to maximize returns to the coffee farmers and thereby promote their social economic welfare. Further, they wanted to address interventions required to remove inefficiencies especially those related to quality, quantity of coffee produced and marketing and to eliminate a bad debt culture among the co-operative societies.

It is well appreciated that the small holder coffee farmer has borne the brunt of the long chain of middlemen in the coffee sale process for a long time. As a consequence of which, he had been grossly underpaid for his coffee crop, and gradually sunk to lower levels of poverty despite being the grower of the Number 2 most valuable worldwide commodity. It is in this regard that coffee societies

decided to register a National coffee marketing society that was to initially market coffee from co-operative societies.

#### b) Membership and shareholding

As per the society's by laws membership is only open to the following: -

- i) Registered Societies that signed the application for registration, and
- ii) Registered Societies that are subsequently admitted in accordance with these by-laws,
- iii) Any Apex Society or Co-operative Unions or national Co-operative organizations registered under the Co-operative Societies Act which has among its members coffee growing societies or any society which is duly registered to deal in coffee production, processing marketing or financing, and has accurate records of its transactions

The founder Coffee Co-operatives and Unions were the following: -

- i) Othaya Farmers Co-operative Society - Othaya, Nyeri
- ii) Meru Central Co-operative Union - Meru
- iii) Mugama Farmers Co-operative Union - Murang'a
- iv) Rumukia Farmers Co-operative Society - Mukurweini, Nyeri
- v) Mutheka Farmers Co-operative Society - Nyeri
- vi) Aguthi Farmers Co-operative Society - Nyeri
- vii) Gusii Coffee Farmers Union - Nyanza
- viii) Lunyerere FCS, - Western
- ix) Machakos District Co-operative Union - Lower Eastern
- x) Kimologit Fcs - Rift Valley
- xi) Co-opholdings Co-operative Society Limited.

An interim Board was formed chaired by Co-operative Alliance of Kenya (CAK) (then Kenya National Federation of Co-operatives) to oversee the implementation and recruitment of members.

There has been subsequent shares drive so we now have 63 paid up co-operative society shareholders as per attached schedule.

The society has elected delegates countrywide from the grassroots who in turn have elected Directors to represent the farmers at the National level.

In regard to the specific issues highlighted on shareholding we wish to highlight on the following: -

1. Directors of KCCE are elected from the grassroots by member co-operatives and any common directors between KCCE and Co-operative Bank have been elected from the grassroots;
2. Co-operative Bank has NO shareholding in KCCE Limited;
3. Individual directors have NO shareholding in KCCE, - not to mention that the shareholding structure does not allow for individual shareholding;


d) Key Highlights from above tables

- i) KCCE, as a marketing agent, does not hold Dollars positions, it converts the Dollars to Kenya Shillings as the farmers need the money in Kenya Shillings;
- ii) KCCE had **NO** money injected by Co-op Bank directors or any other individuals for that matter for as noted earlier, membership is only open to co-operative societies.

In conclusion we hereby emphasise that KCCE has no capacity and did not speculate on the US dollar market, did not receive any funds from individuals and/or any directors from the bank.

KCCE continues to be committed to serving smallholder coffee farmers and will be glad to provide any other clarification that may be required.

Yours faithfully,



LUCY MURUMBA

CHIEF EXECUTIVE OFFICER

CC Speaker of National Assembly

4. The Chief Executive Officer of KCCE reports to the Board of Directors of KCCE Limited.

c) Volumes of Coffee sales

KCCE was established recently as a coffee marketing agent and is still penetrating the market and the highest volume handled is around 10% as shown below: -

**Direct sales**

Period(coffee year)	Total bags sold	Total weight	Value - USD
2009/2010	65,716	3,943,998	17,630,632
2010/2011	11,861	711,606	4,544,002
2011/2012	298	17,851	83,329
	<b>77,875</b>	<b>4,673,454</b>	<b>22,257,963</b>

**Auction**

Period (coffee Year)	Total bags sold	Total weight	Value - USD
2009/2010	-	-	-
2010/2011	21,978	1,318,654	7,957,925
2011/2012	6,457	387,399	2,305,737
	<b>28,434</b>	<b>1,706,053</b>	<b>10,263,662</b>

**Total coffee sold**

2009/2010	65,716	3,943,998	17,630,632
2010/2011	33,839	2,030,260	12,501,927
2010/2012	6,754	405,249	2,389,066
	<b>106,309</b>	<b>6,379,508</b>	<b>32,521,625</b>

## Kenya Co-operative Coffee Exporters Ltd - Shareholders

Society	Region
1 Bukuria fcs	Nyanza
2 Chebich Fcs Ltd	Western
3 Nasianda Marketinfg CS	Western
4 Sibumba Fcs	Western
5 Boma Fcs ltd	Rift valley
6 Khamulati FCS	Rift Valley
7 Kocholwo FCS	Rift Valley
8 Pokot FCS	Rift Valley
9 Gikurwa Fcs Ltd	Eastern
10 Ivinge FCS	Eastern
11 Kagaari South fcs Ltd	Eastern
12 Kagaari South fcs Ltd	Eastern
13 Kamara Fcs ltd	Eastern
14 Kambusu fcs ltd	Eastern
15 Kamuthanga CGCS	Eastern
16 Kamuthanga CGCS	Eastern
17 Kiangagwa fcs	Eastern
18 Kiangagwa fcs ltd	Eastern
19 Kiangua FCS Ltd	Eastern
20 Kianjuri FCS Ltd	Eastern
21 Kanjuu FCS Ltd	Eastern
22 Kibugu Fcs ltd	Eastern
23 Kingoti FCS Ltd	Eastern
24 Kirugui Fcs	Eastern
25 Kirurumwe Fcs Ltd	Eastern
26 Kwa Matingi Fcs	Eastern
27 Meru South fsacco Ltd	Eastern
28 Miitine Fcs ltd	Eastern
29 Mikiki Fcs Ltd	Eastern
30 Mitheru Fcs Ltd	Eastern
31 Muisuni fcs ltd	Eastern
32 Mukiria FCS Ltd	Eastern
33 Muramuki Fcs Ltd	Eastern
34 Mutego Fcs Ltd	Eastern
35 New Runyenies	Eastern
36 Tendelyani Fcs	Eastern
37 Thambana fcs ltd	Eastern
38 Aguthi fcs-Thageini factory	Central
39 Baragwi fcs ltd	Central
40 Barichu fcs ltd	Central
41 Inoi Fcs	Central
42 Iyego FCS Ltd	Central
43 Kabare FCS Ltd	Central

ARICA 17

WAFEE  
LILITA  
KEENA

ORIGINAL  
10/11/11  
10/11/11

Bank of Kenya Limited  
P.O. Box 40000 - Nairobi Kenya  
Telephone: 254 20 200 200 Fax: 254 20 200 200

BSD/03/11

November 14, 2011

Chief Executive Officer  
Family Bank Limited  
P.O. Box 74145-00200,  
NAIROBI



Dear Sir,

**INFORMATION REQUIRED UNDER SECTION 32 OF THE BANKING ACT**

In accordance with provisions of Section 32 of the Banking Act, we hereby inform you that a target inspection of your bank will be carried out on November 14, 2011. The team leader for this inspection will be Mr. R. Ogindo.

Please arrange to avail the information required by the inspectors.

Yours faithfully,

**MATU MUGO**  
ASSISTANT DIRECTOR  
BANK SUPERVISION



## **CENTRAL BANK OF KENYA MARKET OPERATIONS:**

The Monetary Policy Committee at its Meeting on 1<sup>st</sup> November, 2011 made a number of decisions that will henceforth guide its market operations.

The Committee announced a new Monetary Policy Framework wherein all Central Bank Market Operations will be based on the Central Bank Rate (CBR) in order to enhance clarity and certainty. Henceforth therefore:

1. Whenever the Central Bank is injecting liquidity through Reverse Repo, the CBR will be lowest (floor) acceptable rate.
2. Likewise whenever the Bank wishes to withdraw liquidity through a Vertical Repo, the CBR will be the highest (ceiling) rate that it will pay on any bid received.
3. The Bank will continue to quote the amount that it proposes to inject into or mop up from the market in the process of managing liquidity.
4. Those banks utilising the CBK Overnight Window will be charged the CBR plus a high penalty. Banks making use of this facility more than twice in a week will be scrutinised to establish whether prompt corrective action is required.

3<sup>rd</sup> November, 2011

2 December 2011

Alex M. Nandi,  
Banking Supervision  
Central Bank of Kenya

**RE; OVERNIGHT FUNDING AT CBK WINDOW**

Your letter of 1<sup>st</sup> of December 2011 refers

In reference to the guideline on participating in the interbank market and the CBK window on the same day, our understanding is that a bank is not allowed to borrow from the CBK Discount window and on lend to other banks in the overnight market on the same day, therefore creating an arbitrage position. As part of our money market operations, we endeavor to fund from the interbank market as much as possible. In the event that funds are not available in the interbank market, we will come to the CBK Discount window to meet our obligations. Operationally, we are not in a position to refund the borrowed money from the interbank market in order to approach the CBK window. We believe that the intention of the guidelines was not to restrict the latter.

It is important to note that the following actions that have been undertaken by the bank

1. Deposit Mobilization- This effort has helped the bank reduce the overnight position from a high of KES. 2B to approximately KES. 800M. The situation is expected to improve significantly in the next few weeks
2. Raising Long term debt- The bank is in advanced negotiation with medium term lenders to raise long term debt. .

We hope the above reply suffices. Kindly get in touch with us in case of any further queries.

Yours faithfully

PETER MUNYIRI

**CHIEF EXCEUTIVE OFFICE- FAMILY BANK LTD**



## **CENTRAL BANK OF KENYA MARKET OPERATIONS:**

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3<sup>rd</sup> November, 2011

815

Barclays Bank of Kenya Ltd  
Office of the Managing Director  
Barclays Plaza  
P.O. Box 30120 - 00100  
Nairobi, Kenya

Tel +254- 20 - 2214291  
Fax +254- 20 - 2213915

21<sup>st</sup> December, 2011

Mr. Patrick G. Gichohi, CBS  
Clerk of the National Assembly  
CLERK'S CHAMBERS  
National Assembly  
Parliament Buildings  
PO Box 41842-00100  
NAIROBI.

*✓ D.D (c) fees waived  
PO Deal. JN 28/12*



Dear Mr. Gichohi,

RESPONSE TO THE ISSUES RAISED BY PARLIAMENTARY SELECT COMMITTEE

a) Causes of the exchange rate depreciation against the foreign currency and inflation:

- The local unit has been fundamentally weak for several years though benefitted between 2008 and 2010 from a myriad of functions including but not limited to good dollar inflows from tea/coffee, tourism, horticulture, foreign direct investment (FDI) and increased remittances from Diaspora.
- Despite the improving export proceeds, the increased economic growth (4.3% Average for 2011) in a market that is primarily import driven saw demand for dollars increase each subsequent month. This coupled with the globally increasing prices of commodities such as oil has continued to widen our trade deficit and translated into a weaker local unit.
- Drought and sporadic rainfall in 2010 and part of 2011 saw a reduction in food production and increased importation of the food commodities. This translated to a wider current account deficit as imports grew at a much faster pace when compared to exports.
- Additionally the near recession situation in the West and heightened margin calls resulted in capital flight, as investors pulled out their investments in the NSE and other financial products to the safer US dollar. The NSE 20 Share index fell from 4464.9 in January 2010 to 3120.88 in December 2011.
- Spiralling inflation which remained unchecked until October 2011, evidenced by a low interest rate regime left the shilling vulnerable to speculative attacks, driving up the unit to a high of 106.80/107.30 from an opening low of 80.45/80.55. This represented a 32% decline in the local unit.


Inflation:

- Inflation has been very volatile over the last several years, affected by a myriad of both long and short term factors.
- Shortage of food occasioned by sporadic rainfall patterns drove prices high. Inflation rates fell throughout 2010, boosted primarily by falling communication costs due to the competition in the industry.

*James Owen  
pleased  
JN  
28/12/11*

- Growth levels are expected to come down from 4.8% this year to 4.3% according to the latest World Bank survey. Growth however is expected to rise to 5% in 2012 and 5.5% in 2013, subject to Kenya maintaining a stable shilling and inflationary environment and peaceful elections.

Yours sincerely,



Adan Mohamed  
Managing Director

PP



Chairman,  
Parliamentary Select Committee on the  
decline of the Kenya Shilling,  
Kenya National Assembly.

CFC Stanbic Centre,  
Chiromo Road  
Westlands,  
Nairobi

P.O. Box 72833-00200  
Nairobi, Kenya  
Tel: +254 (20) 3638000/  
3268000  
Fax: +254 (20) 3752905/7  
SWIFT: SBICKENX  
cfcstanbic@stanbic.com

NAIROBI

Attention: Honorable Adan Keynan

Date	Direct tel number	In reply please quote	Your reference
19 <sup>th</sup> November, 2011		+254 20 3638672	our reference

Dear Sir,

RE: INFORMATION AND DOCUMENTS REQUESTED

We refer to the meeting held between the honorable members of your committee, our Mr. Fred Ouko and the undersigned on 16<sup>th</sup> instant.

Attached herewith kindly find the Bank's published financials for the period January to September 2011. Kindly note that the income from foreign exchange trading (Part 4.3) reduced by about 6% in the period as compared with the similar period in 2010.

The published financials do also provide information on customer deposits (B 24) for the aforementioned period. We have attached reports on the deposits distinguishing foreign and local currency in respect of 2010 and 2011 in respect of the January to September period. The numbers tally with the published financial report.

On the requested information on our foreign currency (specifically USD/KES) trading volumes, kindly find the third attached. We have traded about USD 3Billion year to date.

As regards the production of documents touching on communication we have had with the Central Bank of Kenya (CBK), kindly appreciate our inability to provide these owing to the fact that we consider it confidential and privileged between CBK and ourselves. We request that you engage with CBK on information that you consider vital for your committee.

Yours faithfully,  
CFC STANBIC BANK LIMITED

Ken Kanyarati,  
HEAD OF LEGAL AND COMPLIANCE  
[kanyaratik@stanbic.com](mailto:kanyaratik@stanbic.com)

CFC Stanbic Bank Limited Registration No. 9520  
A member of the Standard Bank Group of South Africa

Directors: F. N. Ojiambo, SC (Chairman), G. R. Brackenridge\* (Managing Director), J. Babasa-Nzibo, J. G. Kieroni, R. W. Kimotho, G. R. May\*\*, K. Mbatia, C. K. Muchene  
R. T. Ngobi, E. W. Njoroge  
\* South African \*\* British

The Board of Directors of CFC Stanbic Bank Limited is pleased to announce the results of the Bank for the period ended 30th September 2011.

	September 2010 SHE 000 (Unaudited)	December 2010 SHE 000 (Audited)	March 2011 SHE 000 (Unaudited)	June 2011 SHE 000 (Unaudited)	September 2011 SHE 000 (Unaudited)
<b>STATEMENT OF FINANCIAL POSITION</b>					
<b>ASSETS</b>					
1 Cash (local and foreign)	997,803	1,914,172	897,388	1,122,858	892,375
2 Balances due from Central Bank of Kenya	5,846,050	4,129,734	3,806,735	4,283,030	4,630,152
3 Kenya Government securities	12,034,927	10,024,584	10,722,182	10,444,167	10,976,838
4 Foreign currency treasury bills and bonds	-	-	-	-	-
5 Deposits and balances due from local banking institutions	2,717,213	2,278,965	4,517,547	3,319,076	2,078,844
6 Deposits and balances due from banking institutions abroad	2,342,000	1,871,753	2,213,052	10,881,350	2,640,260
7 Kenya Government and other securities held for trading purposes	6,195,260	5,176,850	5,711,806	5,030,771	8,732,802
8 Tax recoverable	51,204,407	50,804,960	60,268,740	68,162,016	68,706,500
9 Loans and advances to customers (net)	-	-	-	-	-
10 Investments securities	-	-	-	-	-
11 Balances due from group companies	12,047,489	16,164,640	11,806,844	8,345,664	16,924,416
12 Investment in associates	15,000	15,000	15,000	15,000	15,000
13 Investment in subsidiaries companies	-	-	-	-	-
14 Investment in joint ventures	-	-	-	-	-
15 Investment in other entities	-	-	-	-	-
16 Prepaid expenses	1,817,000	1,901,440	1,897,293	1,869,453	2,035,520
17 Prepaid interest	76,822	71,822	71,822	70,858	69,633
18 Intangible assets	804,745	810,407	850,713	802,894	771,304
19 Deferred tax asset	-	-	-	-	-
20 Retirement benefit asset	-	-	-	-	-
21 Other assets	1,153,203	1,679,536	2,760,678	1,100,237	8,324,158
<b>22 TOTAL ASSETS</b>	<b>162,015,257</b>	<b>161,132,602</b>	<b>112,648,747</b>	<b>111,351,511</b>	<b>145,270,593</b>
<b>LIABILITIES</b>					
23 Balances due to Central Bank of Kenya	-	-	-	-	-
24 Customer deposits	78,052,018	72,777,816	76,189,876	76,299,512	76,534,507
25 Deposits and balances due to local banking institutions	169,421	1,930,640	541,748	1,510,083	1,325,113
26 Deposits and balances due to banking institutions abroad	8,179,567	10,094,346	16,617,804	16,380,385	36,872,934
27 Other Money Market deposits	-	-	-	-	-
28 Escrowed funds	4,152,918	6,407,742	6,745,748	6,478,192	6,722,734
29 Amount due to group companies	175,505	357,805	228,784	303,284	501,027
30 Taxation payable	250,426	248,827	383,285	85,558	198,126
31 Dividends payable	-	-	-	-	-
32 Deferred tax liability	333,990	310,548	232,884	-	-
33 Retirement benefit liability	-	-	-	-	-
34 Other liabilities	2,276,697	1,755,356	2,540,066	5,445,141	6,858,634
<b>35 TOTAL LIABILITIES</b>	<b>92,632,923</b>	<b>87,182,879</b>	<b>101,827,300</b>	<b>107,544,632</b>	<b>125,135,211</b>
<b>CAPITAL RESOURCES</b>					
36 Share Capital	2,441,375	2,441,375	2,441,375	2,441,375	2,441,375
37 Share Premium	534,118	534,118	534,118	534,118	534,118
38 Reserves	1,385,675	616,152	339,869	(343,313)	(704,813)
39 Revaluation Reserve	4,755,242	4,972,345	5,233,040	5,798,217	6,403,667
40 Retained Earnings	447,847	440,445	520,713	466,017	458,748
41 Statutory Loan Loss Reserve	-	-	220,221	220,221	220,221
42 Proposed Dividend (gross)	808,572	808,572	808,572	808,572	1,003,053
<b>43 Capital Gains</b>	<b>10,352,730</b>	<b>10,824,736</b>	<b>10,112,409</b>	<b>9,511,476</b>	<b>10,135,623</b>
<b>44 TOTAL LIABILITIES &amp; SHAREHOLDERS FUNDS</b>	<b>162,015,257</b>	<b>161,132,602</b>	<b>112,648,747</b>	<b>111,351,511</b>	<b>145,270,593</b>
<b>INCOME STATEMENT</b>					
<b>1. INTEREST INCOME</b>					
1.1 Loans and advances	5,616,088	4,891,742	4,432,907	3,093,151	4,875,392
1.2 Government securities	627,455	785,652	216,171	464,259	732,458
1.3 Deposits and statements with banking institutions	271,679	376,423	11,152	65,903	167,571
1.4 Other interest income	-	-	-	-	-
1.5 Total interest income	6,515,222	6,053,817	4,660,230	3,603,323	5,775,421
<b>2. INTEREST EXPENSES</b>					
2.1 Customer deposits	1,243,157	1,494,593	238,274	498,879	654,426
2.2 Deposits and statements from banking institutions	30,617	87,555	18,041	44,484	124,785
2.3 Other interest expenses	305,752	414,501	188,442	260,254	456,547
2.4 Total interest expenses	1,579,526	1,996,649	444,757	803,617	1,235,758
<b>NET INTEREST INCOME</b>	<b>4,935,696</b>	<b>4,057,168</b>	<b>4,215,473</b>	<b>2,799,706</b>	<b>4,539,663</b>
<b>3. OTHER OPERATING INCOME</b>					
3.1 Fees and Commissions on loans and advances	473,289	589,474	82,358	194,283	351,177
3.2 Other fees and commissions	641,428	938,877	202,378	538,650	871,603
3.3 Foreign exchange trading income	1,048,621	1,389,127	248,216	872,850	953,859
3.4 Dividend income	-	-	-	44,015	41,018
3.5 Other income	1,385,114	1,504,844	285,979	500,519	648,804
3.6 Total other operating income	3,548,432	4,422,322	516,951	1,119,617	1,866,458
<b>4. TOTAL OPERATING INCOME</b>	<b>8,484,128</b>	<b>8,479,490</b>	<b>4,732,424</b>	<b>3,919,323</b>	<b>6,646,521</b>
<b>5. OPERATING EXPENSES</b>					
5.1 Loan loss provision	375,656	573,419	128,945	240,366	410,465
5.2 Staff costs	1,703,598	2,315,085	687,612	1,370,034	2,045,000
5.3 Depreciation	45,431	78,964	10,458	22,150	34,676
5.4 Depreciation on property and equipment	202,511	254,802	68,894	147,954	224,884
5.5 Rental charges	189,085	176,215	43,540	69,618	143,524
5.6 Amortisation charges	117,550	152,716	53,847	107,681	143,524
5.7 Other expenses	2,232,268	2,947,056	641,756	1,375,632	2,113,525
5.8 Total Operating Expenses	4,976,053	6,457,251	1,485,612	2,323,835	3,125,516
<b>6. Profit/(loss) before tax and exceptional items</b>	<b>1,508,075</b>	<b>2,022,239</b>	<b>3,246,812</b>	<b>1,595,488</b>	<b>3,520,965</b>
7. Exceptional items	-	-	-	-	-
<b>8. Profit/(loss) after exceptional items</b>	<b>1,508,075</b>	<b>2,022,239</b>	<b>3,246,812</b>	<b>1,595,488</b>	<b>3,520,965</b>
9. Current tax	691,965	651,870	136,401	644,803	892,546
10. Deferred tax	(73,641)	74,650	22,556	(84,005)	71,029
<b>11. Profit/(loss) after tax and exceptional items</b>	<b>842,469</b>	<b>1,445,019</b>	<b>3,110,967</b>	<b>866,680</b>	<b>2,700,448</b>
12. Earnings Per Share (Kshs)	8.09	12.10	2.85	8.89	15.44
13. Dividends per share	0.00	0.35	0.00	0.00	0.00

	September 2010 SHE 000 (Unaudited)	December 2010 SHE 000 (Audited)	March 2011 SHE 000 (Unaudited)	June 2011 SHE 000 (Unaudited)	September 2011 SHE 000 (Unaudited)
<b>11. NON-PERFORMING LOANS AND ADVANCES</b>					
a) Gross non-performing loans and advances	1,642,690	1,747,860	1,700,163	1,857,721	1,862,253
b) Interest in suspense	185,501	207,889	243,769	252,770	248,173
c) Total non-performing loans and advances (net)	1,457,189	1,539,971	1,456,394	1,604,951	1,614,080
d) Total non-performing loans and advances (gross)	1,628,690	1,755,749	1,723,932	1,880,491	1,880,423
e) Total non-performing loans and advances (net)	1,457,189	1,539,971	1,456,394	1,604,951	1,614,080
f) Total non-performing loans and advances (gross)	1,628,690	1,755,749	1,723,932	1,880,491	1,880,423
g) Net NPLs Exposure (net)	-	-	-	-	-
<b>12. INSIDER LOANS, ADVANCES AND OTHER FACILITIES</b>					
a) Director, shareholders and associates	3,400,779	2,140,482	3,129,875	2,672,477	2,641,844
b) Employees	1,569,022	1,709,432	1,861,070	2,112,760	2,249,209
c) Total Insider Loans, Advances and Other Facilities	4,969,801	3,849,914	4,990,945	4,785,237	4,891,053
<b>13. OFF-BALANCE SHEET</b>					
a) Letters of credit, guarantee commitments	10,886,283	10,457,557	8,308,259	11,318,940	14,391,231
b) Other contingent liabilities	-	-	-	-	-
c) Total Contingent Liabilities	10,886,283	10,457,557	8,308,259	11,318,940	14,391,231
<b>14. CAPITAL STRENGTH</b>					
a) Core capital	7,229,750	7,915,144	7,599,317	6,257,020	8,804,471
b) Minimum Statutory Capital	350,000	500,000	500,000	500,000	500,000
c) Excess/(Deficiency)	6,879,750	7,415,144	7,099,317	5,757,020	8,304,471
d) Supplementary Capital	4,071,161	4,389,167	4,520,272	4,024,520	4,702,464
e) Total capital (a+d)	11,300,911	12,304,311	12,119,589	10,281,540	13,506,935
f) Total risk weighted assets	67,455,052	70,004,024	66,145,420	67,220,039	65,681,431
g) Core capital/risk weighted assets	8.0%	9.7%	9.6%	9.2%	8.4%
h) Minimum Statutory Ratio	8.0%	8.0%	8.0%	8.0%	8.0%
i) Excess/(Deficiency)	0.0%	1.7%	1.6%	1.2%	0.4%
j) Core capital/risk weighted assets	8.0%	10.4%	10.0%	8.5%	9.5%
k) Minimum Statutory Ratio	7.7%	7.4%	7.4%	7.4%	7.4%
l) Excess/(Deficiency)	0.3%	3.0%	2.6%	1.1%	2.1%
m) Total capital/risk weighted assets	16.7%	16.2%	15.6%	14.8%	14.0%
n) Minimum Statutory Ratio	12.0%	12.0%	12.0%	12.0%	12.0%
o) Excess/(Deficiency)	4.7%	4.2%	3.6%	2.8%	2.0%
p) Liquidity	44.7%	36.6%	34.7%	37.1%	29.9%
q) Liquidity ratio	20.0%	20.0%	20.0%	20.0%	20.0%
r) Minimum Statutory Ratio	24.7%	16.8%	14.7%	11.1%	6.9%
s) Excess/(Deficiency)	-	-	-	-	-

MESSAGE FROM THE DIRECTORS  
The Above statement of financial position, income statement and other disclosures are extracts from the financial statements and records of the Bank.

They were approved by the Board of Directors on 23rd November 2011 and signed by:  
I. N. Ojiambo, SC  
Chairman  
G. R. Muiy  
Director  
G. R. Beckwith  
Managing Director  
L. Moiny  
Company Secretary



**CFC STANBIC HOLDINGS LIMITED**  
**IMPORTANT ANNOUNCEMENT**  
**CAUTIONARY STATEMENT**

Capital Market (Futures, Options, Loans and Deposits) and other financial products are subject to market risk. Any loss or gain may be realized only upon liquidation of the Company.

The Directors of CFC Stanbic Holdings Limited on Wednesday 23rd November, 2011 resolved to propose to the Company's shareholders the increase in authorized share capital and the execution of a rights issue upon such terms as the Directors may determine in due course.

The rights issue is aimed at raising capital to fund the growth and expansion plans of CFC Stanbic Holdings Limited and is not intended to provide a return to shareholders.

The rights issue will provide ordinary shareholders of CFC Stanbic Holdings Limited with an opportunity to purchase new shares subject to shareholder approval at an Extra Ordinary General Meeting to be convened on Monday 19th December, 2011, at which of which will be sent to shareholders and published in the newspaper.

The rights issue will be subject to the Company receiving all requisite approvals including approval from the Capital Markets Authority and the shareholders of the Company.

Further details of the proposed rights issue will be provided in due course.

The shareholders of CFC Stanbic Holdings Limited and the public are advised to exercise caution when dealing in the shares of CFC Stanbic Holdings Limited.

By order of the Board  
Company Secretary

Date 23rd November, 2011

**DISCLAIMER**  
This announcement is for informational purposes only and is not intended to constitute, and may not be construed as, a financial offering.

This announcement has been issued with the approval of the Capital Markets Authority pursuant to the Capital Markets (Futures, Options, Loans and Deposits) Regulations, 2002 as amended. As a matter of policy, the Capital Markets Authority assumes no responsibility for the correctness of the statements appearing in this announcement.

CFC STANBIC BANK  
 FOREX TRADING VOLUMES IN USD/KES YEAR TO DATE (2011)

Month	Volume in '000' USD	PnL in '000' KES
Jan	178	13
Feb	207	28
Mar	752	22
April	312	21
May	454	28
Jun	435	38
Jul	166	30
Aug	204	27
Sept	260	35
Oct	118	46
Nov	226	52
Dec	207	13
TOTAL	3,519.00	353

NOTE  
 The volumes and pnl excludes customer flows and resultant pnl and that is why this data differs from published income statement



KENYA BANKERS ASSOCIATION

## PRESS RELEASE

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### RESTRUCTURING LOANS IN A REGIME OF HIGH INTEREST RATES

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Commercial banks have in the recent past revised their lending rates upwards in reaction to the current economic environment where high inflation has occasioned tightening of monetary policy and thus affected short term interest rates. Whereas it is imperative that the rise in inflation be addressed by tight monetary policy, it is also critical that loans already contracted continue to be serviced and also remain affordable to sustain investments and reduce the risk of default.

A high interest rates regime presents three main problems: risk of default, increase in non-performing loans and slowdown in investments. The Monetary Policy Committee(MPC) following its' meeting of 1st December 2011 noted that several banks had commenced discussions with borrowers with a view to restructuring loans and refinancing arrangements to avoid any threat of default. The Committee agreed that this was an appropriate process to be formally encouraged to work out modalities that would enhance these short-run measures to protect borrowers and banks alike.

Taking the cue from the MPC, the Kenya Bankers Association (KBA) has taken steps with a view to protecting customers as well as commercial banks during this temporal period of macroeconomic challenges being experienced.

The KBA has looked at measures that can be availed to existing borrowers to help them ride over this period of tight monetary policy aimed at fighting inflation which has mainly been driven by spiraling food and energy costs. The KBA having consulted with the Central Bank of Kenya (CBK) and the Government will take the following measures:

1. **Loan Repayment Period:** To ensure that borrowers are able to continue servicing their loans during periods of upward revisions of interest rates, banks will negotiate with their customers to extend the loan repayment periods. This may entail extending the period to ensure that the repayments are retained at the existing installment amounts. Extending loan repayment periods will ease the sudden increase in loan repayment burden on the part of the borrowers. It may also serve as an impetus to borrowers to enhance their efforts to fully repay the loan.

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2. **Capping the maximum increase in the loan repayment amount:** Banks will cap the increase in the installment repayment to a maximum of 20% of the current level of installment. The installments will then be spread out leading to extension of the repayment period. This is essentially a combination of spreading the repayment amounts and an extension of the repayment period to fit into the required installment repayment.
3. **Absorption of costs by banks:** Since interest rate adjustments may precipitate loan defaults, banks will absorb some of the additional costs from changes in the macroeconomic environment to the maximum extent possible without threatening their viability. This entails sacrificing a portion of their budgeted profit margin. This measure and the one immediately below are hinged on the premise that while short term interest rates will increase, lending rates are also driven by other factors. These factors include opportunities for investment and overpricing loans may kill avenues for investment. These factors will prevail and will be more important once the inflation war has been won.
4. **Banks will not raise interest rates despite the recent further increase in CBR by 1.5%:** On Thursday, 1st December 2011, the Monetary Policy Committee met and adjusted the CBR upwards by 150 basis points to 18%. Banks will absorb this increase and mitigate the additional burden on existing borrowers. This will apply only to existing borrowers. The interest rates for new loans will however not be accommodated within this measure.
5. **Penalty on Early Repayment of loans:** Where banks decide to increase the interest rates from the contracted rate, borrowers will have the discretion to repay the outstanding loan balance in full or in part without being subjected to early repayment penalties. Waiver of early repayment penalties will ensure that borrowers are not subjected to additional financial burden when interest rates are rising. This will also enable banks to minimize chances of default.

Borrowers should therefore approach their banks for discussions on how they can meet their increased loan repayment obligations while taking advantage of the measures we are announcing today. KBA is confident that these measures will protect the interests of both borrowers and banks. We will continue to take a proactive approach in consultation with CBK and the Government to ensure that investments in Kenya's growth continue being supported through affordable credit. Our efforts will also support the stability of the banking sector by reducing the risk of default.

**RICHARD ETEMESI  
CHAIRMAN  
KENYA BANKERS ASSOCIATION**

13<sup>th</sup> December, 2011

SUBMISSION TO THE PARLIAMENTARY SELECT COMMITTEE  
ON THE DECLINE OF THE SHILLING AGAINST FOREIGN  
CURRENCIES BY MICAH CHESEREM, FORMER GOVERNOR OF  
THE CENTRAL BANK OF KENYA ON 6<sup>th</sup> DECEMBER 2011.

1. The principal function of CBK are:
  - Maintain price stability
  - Regulate the banking system

2. There are two levels of inflation:
  - Overall inflation
  - Underlying inflation

The CBK should only be held responsible for managing underlying inflation which is subject to monetary policy. Other factors that cause overall inflation such as food shortages and fuel price increases are outside the control of the Central Bank.

3. CBK has very capable economists. It is most surprising that they allowed a very expansionary regime of money supply to persist for so long. It appears their advice may have been ignored. Table I attached indicates the trends that should have rung alarm bells in the ears of the technical experts inside the Central Bank.

4. The main causes of the recent shilling depreciation included:

4.1 Deteriorating current account deficit. Falling exports and rising imports.

4.2 Purchase of dollars by the CBK at a time when there was already a shortage of forex.

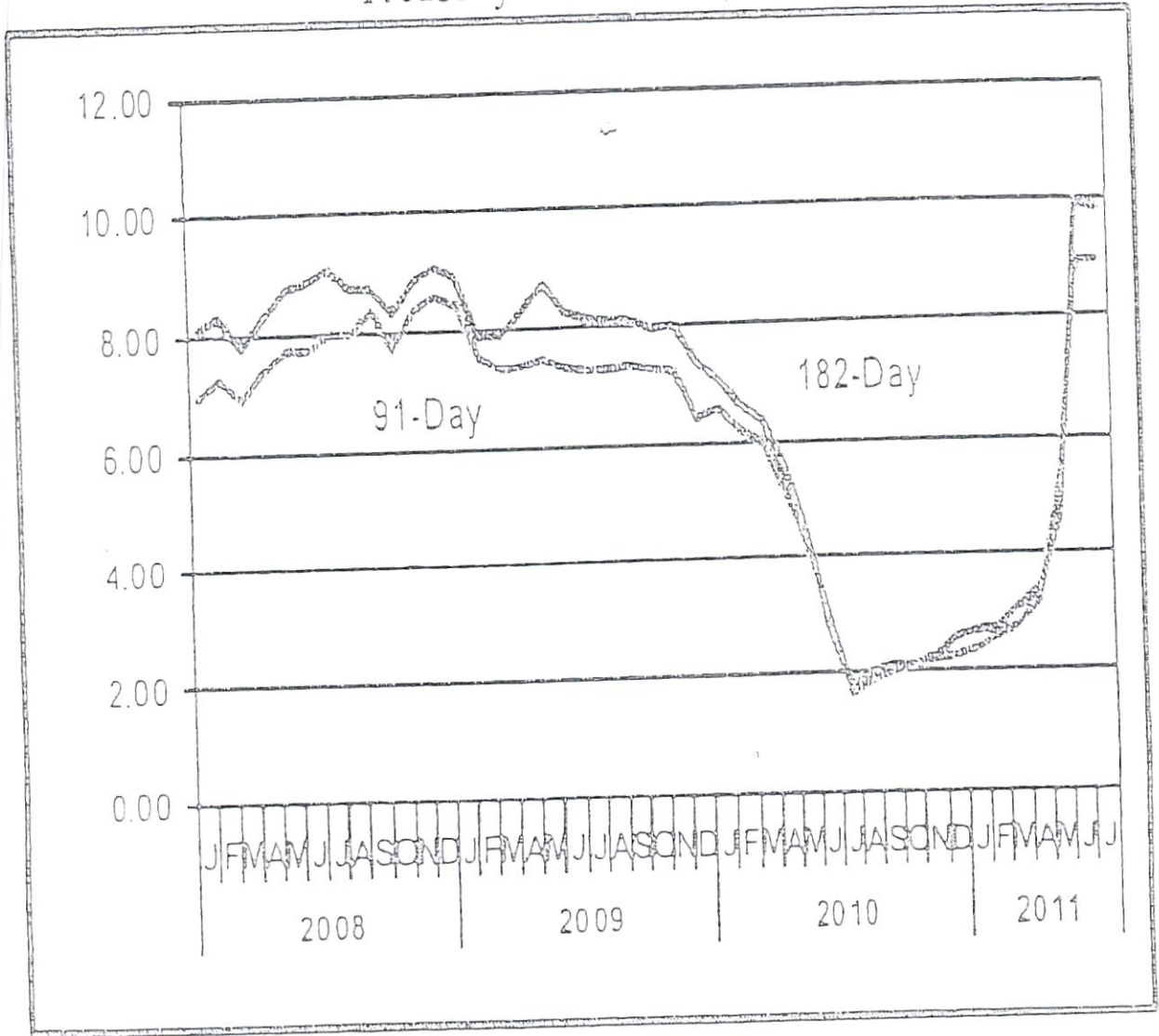
4.3 Pronouncement that CBK was not going to intervene to save the shilling from depreciation. This encouraged speculators.

4.4 Purchase and repatriation of dollars by foreigners and some locals who had invested in Treasury Bills following very low levels of interest rates. They opted to invest their funds in overseas money markets earning positive interest rates.

## RECOMMENDATIONS

1. CBK economists to explain to the Parliamentary Committee the advice they made to the Monetary Policy Committee to mop up excess liquidity.
2. CBK should not make its intentions known with regard to interventions in the forex market.
3. Raise the CBK lending rate but not too excessive as this will damage the economy. Both the public and private sectors will be adversely affected.
4. Do not allow the shilling to over-appreciate as this will discourage tourists and make Kenyan exports non – competitive.
5. Everyone to exercise patience since impact of monetary policy actions take time to produce results.
6. Government to be encouraged to implement austerity measures so that they can reduce their borrowing from the money market. This will ease pressure on interest rates.
7. Consider the pros and cons of including external members in the Monetary Policy Committee.
8. CBK to be required to be appearing before the appropriate Parliamentary Committee on a regular basis, say quarterly or half-yearly, to explain the performance on their two core mandates of price stability and the financial stability of the banking system. This will be in the spirit of openness and accountability in the management of public finances as required by our new constitution.
9. Future appointments to the positions of Governor and Deputy Governor should be through competitive process with a panel interviewing the candidates.

# Treasury Bill Rates (%)



## KENYA PRIVATE SECTOR ALLIANCE (KEPSA) REPORT ON THE PERFORMANCE REVIEW OF THE KENYA SHILLING

### **Introduction**

Since early this year, the shilling has been on free a fall creating unpredictability, high cost of imports, inflation, among others. The Government, in consultation with other stakeholders instituted various measures with far reaching consequences to the private sector as well as the general public and consumers. Almost all the sectors of the economy were affected with majority registering negative effects. This was also coupled by high inflation rate. Based on the above, KEPSA invited business leaders from various sector for a brainstorming session on 11<sup>th</sup> November 2011, to analyze performance of their sector viz a vis the shilling. The meeting was chaired by the KEPSA chairman Eng. Patrick Oboth.

During this meeting, he gave an overview of the performance of the shilling which has consistently lost value against the US dollar. It was agreed that there is need for private sector to focus on other factors affecting the economy, rather than the shilling and get a balanced view on the different agendas.

Key areas and factors to look into towards stabilizing the shilling were outlined as follows.

- Foreign and domestic debt management
- Infrastructural development
- Cost of running the government
- Private sector efficiency in production
- Central Bank governance structure

### **Foreign and domestic debt management**

Participants requested for information on how much the Domestic/external debt is and how (much) it is being serviced. In this case, policies need to be put in place to ensure debt coordination, as well



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coordinate what percentage of money outflow goes into debt servicing. Most of the notes serviced in debt are in Dollars, this then brings a significant impact of the performance of the Shilling.

To this end, the Treasury and CBK, should avail all the relevant information to the Private sector.

### **Infrastructural development**

- Members agreed on the importance of having improved and efficient infrastructure to the growth of the economy. Good road network for example, reduces the fuel wasted in traffic jam. It was pointed out that high inflation increases the cost of projects leading to stoppage of some when the government cannot pay the contractors in good time.
- Foreign funded projects are not fully paid for and the government has to buy dollars to pay for its part. This raises the demand for the dollar hence pushing inflation further high. It was agreed that some of these projects should be sub-let to local contractors to reduce the demand for foreign currency.
- There is need to have policy guidelines on how the projects towards infrastructural development are implemented. There should be a mechanism to look into the mega projects and their execution processes.

### **Recommendation:**

- There is need to identify what can be imported for the projects and what should be produced locally. That is, need to look at the ratio of inflow and outflow in the projects.
- Some machinery from local companies should be used to avoid using dollars to export machinery while they are locally available. To this effect, members agreed that the local machines need to be given incentives so as to make the imported ones more expensive and hence unattractive to the local industry. These incentives make inputs cost effective and the local production inexpensive.

- There should also be a reduction in the cost of energy or incentivize industries competing with imported raw materials
- Kenyans should be encouraged to buy what is Kenyan though the market is liberalized and this should not infringe people's right to buy anywhere
- It was agreed that foreign contractors need to share their work with local contractors to enhance knowledge transfer.
- It was recommended that contracts above a certain level must involve a local component to enhance knowledge transfer and lessen demand for the foreign currency.

### **Cost of running the government**

- Members agreed that the cost of running the government is too high putting pressure on the scarce resources. The revenue allocation commission should look into how well the revenue is utilized to ensure that the excess money is channeled into infrastructural development.
- Need to enhance transparency and do away with corruption and mismanagement of public funds.
- Members agreed that the devolved government should be effected in phases for cost efficiency and to maintain stability.
- The central government should deal with policies, resource mobilization and monitoring and evaluation. The rest is done by the county government to cut on the cost of running the government.

### **Private sector efficiency in production**

- It was noted that the increased cost of goods is partly caused by inefficiency in production which is then passed on to the consumer. It was therefore pointed out that the private sector has a role to play in ensuring there is efficiency in production.
- There is need to improve efficiency of Kenya pipeline as well as the entire supply chain to cut on energy cost.
- Harnessing of coal should be fast-tracked to enhance development of power in a different way. It should also be fast-tracked so as to cut on the energy costs incurred through importation.

- Members agreed on a need to harmonize companies involved in energy supply and target tariffs to avoid competition. To this effect, a committee should be formed in both public and private sector to regulate competition.
- There is need to improve infrastructure efficiency and capacities by giving incentives to companies whose vehicles reduce congestion on the roads, such as double-decker buses. Buses should be upgraded to encourage people to ride in them.
- There should be sanction measures for engineers who carry out their projects inefficiently.
- The education sector needs to set up standards of education to be able to supply the region with skills needed for efficiency as well as enable Kenyans acquire international contacts as a way of earning foreign currency.  
Education tourism promotion will also have a boost in the economy.
- In the issue of ICT and BPO it was reported that there is need for local IT companies to partner with international companies for technology transfer and to enable the companies acquire international projects.
- The impact that cartels have on the economy should be looked at intensively and independently. The Competition Authority is yet to make an impact.
- Inefficient sectors should be made efficient.
- The import storage facility in Mombasa needs to be commissioned to cut on the additional costs imports incur at the store.

#### **Central Bank governance structure**

- Members agreed that there should be a commission to which the central bank reports periodically. This should be an independent body. Members noted that the CBK Governors chairs the MPC as the policy making organ and he is also the implementer. The nomination of the members of the MPC is also shrouded in secrecy hence bringing in the suspicion
- The central bank should address and interrogate any political pressures on the shilling. They noted that this free fall is always witnessed when the county is approaching the General Election.
- The central bank should look into the volatility of the exchange rate and put in place measures to enhance confidence in its consistency

- There should be a balance between the fiscal and monetary policies and debt management.
- CBK should have a working relationship with Banks and other FOREX dealers in order to share information

### **Role of NESAC**

- Members need also to know the role of NESAC which is, policy coordinating advisory Council of the Government. Members felt that NESAC should provide more policy direction as it seems that there is a disconnect between CBK and Treasury in regard to fiscal and monetary policies. Role of NESAC should be enhanced

### **Conclusion**

- There is need to do a thorough benchmark with other comparative economies
- Food insecurity and its impacts on the economy. There is need to put in place measures for population control.
- There should be regular meetings for further discussions as the monitoring of the shilling continues.



ANNEX 18

X



PARLIAMENTARY SERVICE COMMISSION

Parliamentary Budget Office

Parliamentary  
Budget Office  
Nairobi,  
Kenya

KENYA SHILLING EXCHANGE RATE

NOVEMBER 2011

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## BACKGROUND

1. The Kenyan economy is going through turbulent times. Throughout 2011, the country has suffered from a series of price shocks that has seen inflation skyrocket to unbearable levels. Concurrently, the Kenyan shilling depreciated against major currencies, hitting historic low of Ksh.107 against US dollar. The combined effects of rising inflation and a weakening shilling have drastically increased the cost of living and made life unbearable for Kenyans. The situation combined with other downside risks is likely to slowdown economic growth prospects as is already the case for the 2<sup>nd</sup> quarter of 2011.
2. This paper is a brief review of the Kenya shilling exchange rate against major currencies especially the US dollar. It will outline the current scenario, the causes of exchange rate volatility as well as a synopsis of the current intervention measures. The brief is expected to trigger more debate around the strength and stability of the shilling so that policy makers and other stakeholders can propose concrete measures to deal with the situation.

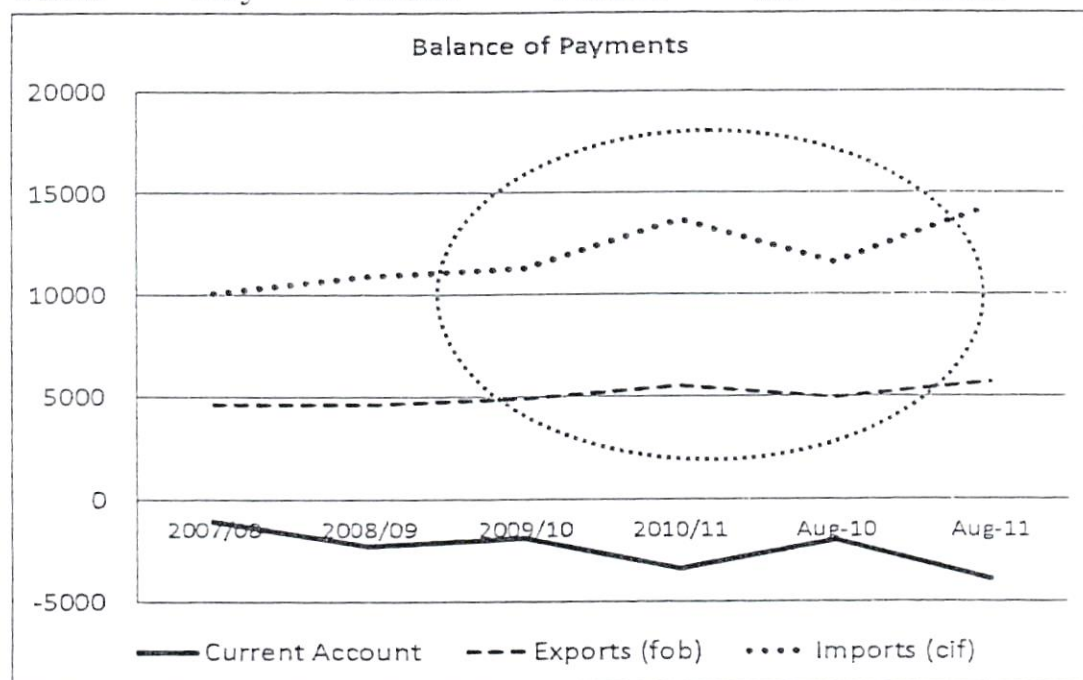
## RECENT DEVELOPMENTS IN THE KENYA SHILLING EXCHANGE RATE

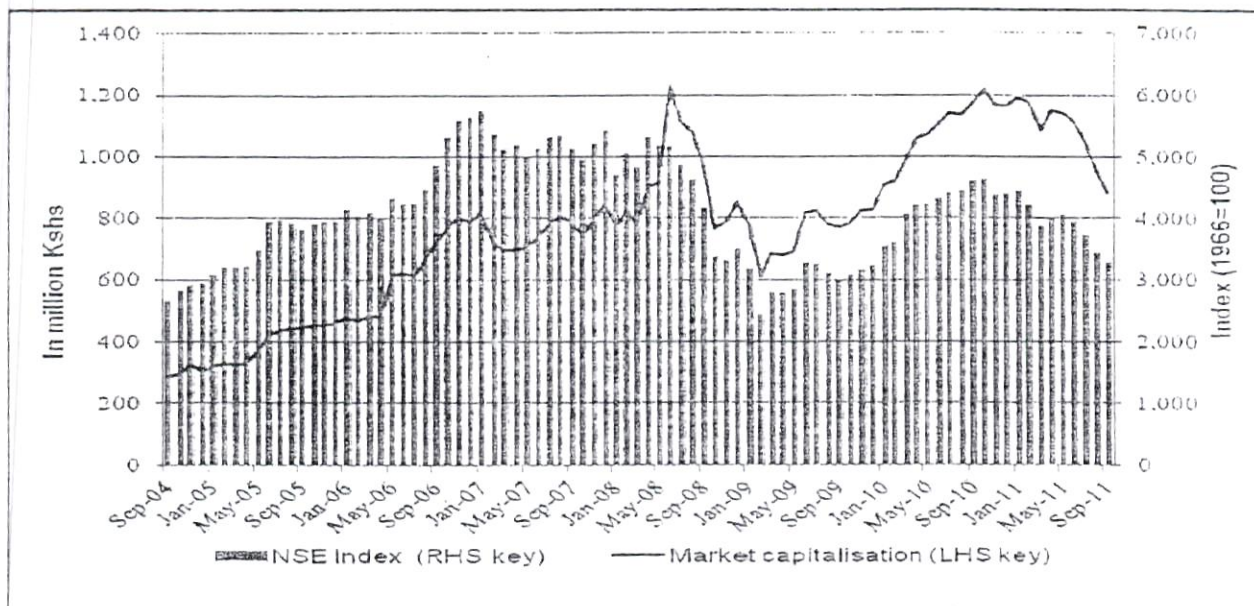
3. The Kenya shilling has substantially weakened relative to major international currencies since the start of the year. It lost 32% percent from Ksh.80.80 to the US dollar on January 3<sup>rd</sup>, 2011, to a lowest ever mean rate of Ksh.107 to the dollar on October 12<sup>th</sup>, 2011. It is noted that the shilling last touched the Ksh.100 per 1 US\$ on March, 1994, at the height of the Goldenberg scandal. The shilling has started appreciating against the dollar over the past few weeks.

5. To combat inflation and exchange rate volatility, Central Bank of Kenya raised its benchmark lending rate by 5.5 percentage points to a record 16.5% on 1<sup>st</sup> November 2011. The Cash Reserve Ratio (CRR) or the proportion of deposits that banks are required to keep at the CBK was also raised to 5.25%, with effect from mid-December. This tightening of the monetary policy is expected to increase cost of borrowing thereby reducing money supply in the economy, demand for goods and services and curbing inflation. These policies appear to have some effect since the shilling has appreciated by 14.5% from its record low of 105.96 on 12<sup>th</sup> October to 91.05 on 21<sup>st</sup> November.

### POSSIBLE CAUSES OF WEAKENING OF THE SHILLING

6. **Current Account Deficit:** An analysis of the current account indicates that there has been a gradual and sustained deterioration. This widening gap between imports and exports of merchandise goods means that the country needs more foreign exchange for imports than it receives from exports, hence exerting pressure on the shilling. High inflation further worsens the situation since it raises the cost of export products relative to countries with lower inflation. Thus, even though a depreciated shilling is good for exports, high inflation tends to reduce our export competitiveness which may further worsen the current account.





Source: Treasury, First Quarter QEBR 2011

10. **Speculation:** The depreciation of shilling may have been further driven by the sentiments of the financial markets rate. Speculators may have read the market and taken the position that the shilling will weaken further thus raising demand for more dollars in order to make a profit. At the onset of Kenya shilling depreciation, Central Bank blamed (some) commercial banks for speculation by hoarding dollars. The commercial banks on the other hand blamed the CBK for lack of policy clarity and consistency in stabilizing the shilling.
11. **Disruptions in Inflow of Funds from Neighboring Countries:** There has been a steady and unregulated inflow of foreign currency from the neighboring countries and this has served to artificially prop up the local currency by increasing its demand. With the recent remedial actions on piracy and policing of the country's borders, this inflow of foreign exchange has decreased and thereby put downward pressures on the shilling.
12. **Non Responsive Monetary Policy Stance:** The authorities responsible for regulating the supply of both local and foreign currency were unhurried in taking remedial action to ease the slide of the Kenyan

- ii. Increasing loan defaults as it becomes more expensive to service variable rate loans and stay afloat for most businesses and households,
  - iii. Fueling cost related inflation. This happens when companies increase their price margins to compensate for costly bank financing or capital. This is particularly one way where rising interest rates could undo the CBKs effort to contain inflation.
- Lowering the Foreign Exchange Exposure Limit of Commercial Banks from 20% to 10%,
  - *This measure served to make foreign currency more readily available and therefore cheaper (in relation to the Kenyan Shilling) by forcing banks to hold less foreign currency assets, which also reduces foreign currency dealings and speculation.*
- Receipt of Extended Credit Facility (ECF) from the IMF

14. Kenya secured an additional \$250 million under the ECF arrangement of the IMF to shore up the local currency and ensure that the country's balance of payments remained stable. It is important to note that since the weaker shilling makes imports more expensive, it reflects negatively on the country's balance of payments since Kenya's economy is import dependent.

## MEDIUM-TO- LONG TERM POLICY OPTIONS TO ENSURE STABILITY OF THE EXCHANGE RATE

Evidence shows that the recent weakening of our currency was occasioned by a combination of factors among them: increased demand for foreign exchange to meet imports for food stuffs to deal with the chronic food shortages in Kenya and the horn of Africa;; speculative foreign currency dealings by local market players driven by uncertainty in the market; external factors such as the strengthening of the dollar relative to the euro; large current account deficit, among other factors. In order to mitigate such effects, it is proposed that:



measures to increase output of foodstuffs as well as encouraging local production of some of the imported products in order to reduce overreliance on imported products and discourage importation of non-essential goods through non-tariff barriers.

- **Maintain the policy of Market determined exchange rate and intervene to reduce short term volatility**

18. Though this is indeed the policy stance of the CBK with regard to the exchange rate, recent volatility in inflation and exchange rates implies that the exchange rate may be out of sync with these variables. There is need to restore stability in all these factors. With regard to the Kenya shilling we should allow the exchange rate to settle at a level that permits;

- i. Modest import of essential goods and services,
- ii. Promotes export led growth.
- iii. Ensures that the goods produced locally are attractive to our major trading partners, i.e. Uganda, Tanzania and Rwanda.

This can only be done by achieving stable inflation, reasonable interest rates, and growth. Artificially propping up the currency at the expense of growth could further destabilize the economy. Thus, measures to address the exchange rate depreciation through constraining lending and through high interest rates should be done cautiously. It can be noted that appreciation could in fact hurt exports, and if import bill does not adjust much, it would again worsen the current account and cause depreciation of the shilling. Still one of the best ways to address the exchange rate is through supporting industries that can reduce our import dependence and also promoting exports.

- **Moral Suasion**

19. With the recent depreciation of the Kenya shilling, it is evident that information flow from the Central Bank has been seen by the commercial banks as one-sided. This is evident with the proposal to CBK to bypass commercial banks and buy foreign exchange from major foreign exchange earners and sell to targeted sectors of the economy. There is therefore