REPUBLIC OF KENYA
THE NATIONAL TREASURY AND ECONOMIC PLANNING

NOTICE TO THE CENTRAL BANK OF KENYA ON THE PRICE STABILITY TARGET AND THE ECONOMIC POLICY OF THE GOVERNMENT FOR THE FINANCIAL YEAR 2023/24 BUDGET

The principal objectives of the Central Bank of Kenya (CBK) as established in Cap 491, Section 4 (Subsection 1, 2 and 3) of the Central Bank of Kenya Act, 2015, are:

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

In addition, subsections 4 - 5 provides that the Cabinet Secretary responsible for Finance shall specify at least once in every period of 12 months:

a. The price stability target of the Government, in consultations with the Central Bank; and,
b. Economic policy to be taken by the Government.

Further, subsection 6 of the Act requires the Cabinet Secretary to publish the Notice in such a manner he deems fit and lay a copy of the Notice before the appropriate Committee of the National Assembly.

In compliance with the provisions of the CBK Act (2015), this notification sets out the price stability target and the economic policy to be taken by the Government in the FY 2023/24 as follows:

A. Price Stability Target

In the FY 2022/23, inflation rate has remained above the 7.5 percent upper bound target set in the National Treasury's notification to the Central Bank of Kenya on Price Stability Target for FY 2022/23, dated 6th June 2022. As required in the National Treasury's notification, the Central Bank of Kenya through letters dated December 13, 2022 and June 5, 2023, appraised the Cabinet Secretary for the National Treasury and Economic Planning on the reasons why overall inflation had remained above target and outlined the measures the Central Bank of Kenya is taking to address the deviation. These letters were copied to the Clerk and the appropriate Committees of the National Assembly.

As per the letters, the higher inflation rate was mainly due to high food and energy prices following adverse weather conditions and high global oil prices but also compounded by a pass-through effect from domestic currency depreciation. In order to anchor inflation expectations, the Central Bank of Kenya through the Monetary Policy Committee tightened monetary policy during the last one year by raising the Central Bank Rate to 10.5 percent in June 2023 from 7.5 percent in May 2022. This monetary policy action together with improved agricultural production occasioned by the long rains and supported by the fertilizer subsidy program, and the ongoing importation of key food items particularly maize, cooking oil, rice and sugar under the duty-free window are expected to ease the domestic prices of food items.

In order to sustain macroeconomic stability, the inflation target for FY 2023/24 is set at 5.0 percent, with a flexible margin of 2.5 percent on either side in the event of adverse shocks. This inflation target will be measured by the 12 month increase in Consumer Price Index (CPI) as published by the Kenya National Bureau of Statistics (KNBS). The target is in line with the macroeconomic developments underlying the FY 2023/24 Budget and the Medium-Term Expenditure Framework (MTEF) for the period (FY 2023/24 - FY 2025/26). The macroeconomic targets support the economic policies of the Government as detailed in the 2023 Budget Policy Statement and were developed by the Inter-Agency Macro Working Group while preparing the expenditure ceilings for the FY 2023/24 Budget.

The Central Bank of Kenya is in this respect expected to achieve this 5.0 percent inflation target and will be accountable to the Government and the general public for its attainment. The flexible margin of 2.5 percent on either side of the inflation target is to cater for effects of external shocks such as the adverse impact of the Russia-Ukraine conflict and other global disruptions on the Kenyan economy. Domestic shocks may emanate from unfavourable weather conditions that may affect agricultural production. Maintaining inflation rate at this level will help preserve macroeconomic stability and reduce undesirable fluctuations in economic performance.

In the event that inflation rate as published by KNBS, deviates from the target by more than 2.5 percentage points in either direction, the CBK will provide a letter indicating:

- The factors driving inflation away from the specified target by more than 2.5 percentage points in either direction;
- The measure(s) which the CBK is taking to address the deviation; and
- The time period within which the CBK expects inflation to return to the target.

A copy of this Notice will be shared with the appropriate Committee of the National Assembly, and in case of deviation from target, CBK will also be expected to share a copy of the letter explaining the deviation to the Chairperson of the same Committee. If the deviation persists for three consecutive months after the initial letter, CBK will be expected to send another letter further explaining the deviation from the target. In assessing the inflation developments, the Government will consider the prevailing economic conditions at the time.

B. Economic Policy to be taken by the Government

As stated in the June 15, 2023 Budget Statement, the theme for this year's budget is: *"Bottom-Up Economic Transformation and Climate Change Mitigation/Adaptation for Improved Livelihoods of Kenyans".* As such, the economic policy of the Government in the FY 2023/24 Budget targets to scale up implementation of policy priorities and structural reforms under the Bottom – Up Economic Transformation Agenda (BETA) as detailed in the 2023 Budget Policy Statement and the Fourth Medium Term Plan (MTP IV). This will guide attainment of development objectives as well as the continuation of the Kenya Vision 2030 and the Sustainable Development Goals (SDGs).

Global growth is projected to slow down to 2.8 percent in 2023 from 3.4 percent in 2022 largely due to the sluggish growth in advanced economies. On domestic scene, the growth momentum slowed down to 4.8 percent in 2022 from 7.6 percent in 2021 as a result of suppressed agricultural production, owing to adverse weather conditions. The growth in 2022 was supported by the services sector particularly transport and storage, financial and insurance, information and communication, and accommodation and food services. The economy is expected to remain resilient in 2023 and grow by 5.5 percent and maintain that momentum over the medium-term supported by a broad-based private sector growth and ongoing public sector investments. This growth outlook over the medium term will be reinforced by the implementation of the strategic priorities under the Government's Bottom-Up Economic Transformation Agenda (BETA).

The Agenda will involve increasing investments in five strategic sectors that have the largest impact and linkages to the economy as well as on household welfare as the starting point. These include: Agricultural Transformation; Micro, Small and Medium Enterprise Economy; Housing and Settlement; Healthcare; and, Digital Superhighway and Creative Industry. Special focus will be placed on the interventions that: reduce the cost of living; create jobs; achieve more equitable distribution of income; enhance social security, expand tax base for more revenues to finance development; and increase foreign exchange earnings. The Government has identified nine key value chain areas for implementation, namely: Leather, Cotton, Dairy, Edible Oils, Tea, Rice, Blue economy, Natural Resources (including Minerals and Forestry), and Building Materials. This approach will ensure that there is no break in the cycle of resource allocations and that adequate resources are allocated to the entities along the value chain. This will help to eliminate duplication of both roles and enhance efficiency of available budgetary resources.

In order to complement the monetary policy and anchor macroeconomic stability, the fiscal policy supporting the FY 2023/24 and the Medium-Term Budget framework aims at undertaking a growth-friendly fiscal consolidation designed to slow down the annual growth in public debt. This will be achieved through improved revenue collection, primarily through broadening of the tax base, and containing overall expenditure to the set target, while prioritizing high impact social and investment expenditure. In this regard, fiscal deficit including grants is expected to gradually reduce from 6.2 percent of GDP in the FY 2021/22 to 5.8 percent of GDP in the FY 2022/23 to 4.4 percent of GDP in the FY 2023/24 and further to 3.6 percent in the FY 2025/26.

As outlined in the Budget Statement delivered to the National Assembly on 15th June 2023, price stability is one of the prerequisites for a stable macroeconomic outlook underpinning the FY 2023/24 Budget. It is therefore expected that the CBK will maintain inflation within the target range during the FY 2023/24 Budget period.

Accountability

The Central Bank of Kenya and the Monetary Policy Committee is accountable to the Government for the price stability target set out in this Notice. In this respect, the accountability framework in terms of regular reporting will remain as outlined in sections 4B, 4C and 4D of the CBK Act, 2015. The format of reporting to the National Assembly remains as previously stated.

Revision of the Target

The revision of the inflation target will be set out in the Budget for the FY 2024/25 that will take into account updates of the Government's Economic Policy objectives in the 2024 Budget Policy Statement.

NJUGUNA S. NDUNG'U, CBS
<u>CABINET SECRETARY</u>

June 27, 2023