

**KEYNOTE ADDRESS BY THE MINISTER FOR FINANCE AT THE FIRST QUARTELY LAUNCEON OF THE YEAR OF THE PETROLEUM INSTITUTE OF EAST AFRICA HELD AT THE INTERCONTINENTAL HOTEL, NAIROBI, ON 11<sup>th</sup> APRIL 2012, 12.00 PM.**

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**Chairperson, Petroleum Institute of East Africa;**

**Manager, Petroleum Institute of East Africa;**

**Permanent Secretaries present;**

**Senior Government Officials;**

**Private Sector Representatives;**

**Development Partners;**

**Regulatory Reform Experts;**

**Representatives of the Oil Marketing Industry**

**Distinguished guests;**

**Ladies and Gentlemen**

1. It gives me great pleasure to be with you this morning as you deliberate on issues touching on the petroleum sector. Indeed, I feel honored by the Institute decision to invite me to talk on the measures the Government is undertaking to control inflation which in the recent past threatened to negatively affect the positive gains made in our economic recovery efforts.

2. I will therefore in my remarks this morning spend more time on the measures both short term and long term that the government has taken to dampen the persistent inflationary pressures and stabilize the exchange rate.

3. We all applaud the efforts made by the Government since 2003 to safeguard our macroeconomic stability. The Government has continued to pursue prudent and sustainable macroeconomic policies that ensure low and stable inflation, interest rates as well as competitive exchange rate which have formed the foundation of remarkable higher growth rates achieved in the recent past.

**Ladies and Gentlemen,**

4. You will recall that the year 2010 saw the country experience a strong economic recovery. We achieved a Gross Domestic GDP growth rate of 4.9 percent in that year as compared to 1.6 per cent in 2008. The recovery was robust and broad based and touched all sectors. We were able to overcome the quadruple shock of 2008 and 2009 post-election violence, drought, and the global food and financial crisis and achieved balance growth in all sectors. The favorable weather conditions led to the recovery of agri-

culture and also contributed to more reliable energy occasioning immediate positive impact on the manufacturing sector.

5. Our remarkable progress made in 2010 faced challenges in 2011 that almost reversed these achievements. The inflationary pressure and exchange rate volatility escalated in 2011 as a result of a combination of domestic and international economic developments. Inflationary pressures peaked in response to increasing food and fuel prices due to persistently high international oil prices. After remaining low and stable at single digit for a greater part in 2010, inflation picked to reach double digits level in 2011.

6. By November 2011, overall inflation reached the highest of 19.7 percent. Underlying inflation measured by excluding food and fuel from the overall Consumer Price Index (CPI) basket also increased to about 10 percent by the end of the same period. In addition, the strong domestic demand fuelled by the rapid growth in bank credit to the private sector reached 34.8 percent in October 2011.

7. In the same period, the shilling depreciated considerably against the major world currencies. This was as a result of the build-up in the current account deficit due to the rising import bill for imports of machinery and transport equipment necessary for the economic recovery process as well as uncertainty in the global financial markets that was caused by the debt crisis in the Eurozone. The shilling exchange rate weakened against the major currencies to exchange at an average of Ksh 101.3 per US dollar in October 2011 compared with about Ksh 80 per US dollar in 2010.

**Ladies and Gentlemen,**

8. You have since January 2012 witnessed the appreciation of the Kenya Shilling. This has been partly due to the tightening of monetary policy. The CBK has raised the policy rate by about 12 percentage points during the last four months. The adjustment in interest rates is expected to encourage capital inflows, boost foreign exchange reserves, and support stability in prices and the shilling exchange rate.

9. We intend to continue with tightening of monetary policy to dampen the persistent inflationary pressures and stabilize the exchange rate. We will also continue to review our monetary policy operations in order to enhance liquidity management both in the short and long term.

**Ladies and Gentlemen,**

10. Other measures being taken by the Government include increasing our official foreign exchange reserves which have remained slightly below US\$ 4 billion, equivalent to 3.7 months of import cover, which is below the statutory requirements of 4 months of import cover. Balance of payments challenges and volatility in foreign exchange market have not allowed the CBK to gradually build up foreign exchange reserves. To improve on this situation we have sought additional balance of payments support under the ongoing Extended Credit Facility arrangement with the International Monetary Fund to deal with current challenges. The additional disbursements will improve our official foreign exchange reserves held by the Central Bank. In the long run with the stabilizing exchange rate, the Government will be able to meet such challenges.

**Ladies and Gentlemen**

11. As you are aware, Kenya is a net importer of petroleum which accounts for 22% of our primary energy sources. The demand for petroleum has been growing steadily at above 10 per cent per annum over the last decade. It is no doubt then that petroleum as sources of energy is one of the main drivers of the modern sector of the economy.

12. As the sector relies wholly on the importation of all petroleum requirements, there is definite exposure to international price volatility resulting from various factors which in effect has full repercussion on the cost of petroleum imports and subsequently local cost of petroleum products as happened in a better part of 2011 following the unrest and instability in North Africa and Middle East.

13. Indeed, as crude and refined petroleum products are procured with US dollars which are purchased by the importer-Oil Marketing Company (OMC) to pay the supplier, the depreciation of the Kenya shilling against the dollar accelerates the increase in the cost of petroleum, as was observed since the third quarter of last year, and subsequently adversely impacted on the inflation rate.

14. We are consulting with the relevant stakeholders in this sector on possibility of establishing strategic petroleum reserves by building storage capacity. The private sector is being encouraged to partner with the public sector to expand the existing capacities or investing in new ones in the already identified suitable locations.

15. To cushion the consumers against unscrupulous petroleum retail businesses the sector has been regulated since December 2010 by the Energy Regulatory Commission (ERC) using a retail pricing formula where all cost elements in the petroleum supply chain are analyzed and reflected in the final consumer price. The formula is reviewed periodically to take into account emerging factors that may hinder the growth of the sector including among others interest rates and inflation.

16. You will realize that although, we have no control on the external factors that affect petroleum prices and indeed security of supply, there are key areas of improvement that have commenced. There are proposed plans to be undertaken to grow and make the sector more effective and efficient and thereby guaranteeing affordable and reliable petroleum supply. The modernization of the Kenya Petroleum Refinery through the public private sector partnership will see the expansion in critical infrastructure specifically in import, storage, transport and distribution facilities needed.

17. May I take this opportunity to thank the Oil industry support and adherence to government policies and strategies that has promoted increased consumption of Liquefied Petroleum Gas (LPG). The compliance of the industry towards government's efforts to standardize regulators and valves is aimed at not only increasing per capita consumption of LPG through accessibility but also saving trees which is commendable. LPG will soon become affordable to Kenyans with the commissioning of the LPG import and storage facility in Mombasa due in September this year. This will further compliment the quick realization of similar facilities in Nairobi and major towns thereby increasing LPG consumption which is a modern efficient energy source.

18. The unit cost of LPG will also reduce significantly as the factors related to constrained LPG infrastructure will be eliminated accordingly specifically, high freight costs associated with the current small import parcels and eradicate the demurrage costs which accrue on LPG imports due to lack of adequate onshore LPG storage facilities.

**Ladies and Gentlemen,**

19. The Value Added Tax (VAT) laws are undergoing major changes and various and we have received major key proposals from the various sectors to be incorporated into the VAT Bill 2012. For example, we

have received proposals that the government removes all duties and VAT from LPG appliances (cookers, cylinders and accessories). This is a bid to make LPG, more affordable and further expand usage of LPG especially in the rural areas. We are studying these proposals and we will provide the directives when the studies are complete.

### **Ladies and Gentlemen**

20. Oil discovery in Kenya would mean reduction of the petroleum import bill and have cheaper oil for local consumption. We are continuing with more oil exploration activities in the various exploration blocks in the Country with the hope of striking oil in the near future.

21. Finally, may I take this opportunity to conclude my remarks with a note of appreciation that, although the business environment has been turbulent for the Petroleum Sector, Oil Marketers have continued to meet their prime goal and obligation of ensuring effective and sufficient supply of petroleum products to all consumer segments locally and also regionally.

I wish you fruitful deliberations in this luncheon.

**Thank you very much.**

**11<sup>th</sup> April 2012.**