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MONETARY POLICY IN ECONOMIC SHOCKS: A CRITICAL REVIEW OF KENYA'S COVID-19 RESPONSE

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ABSTRACT

This paper delivers a critical, document-based review of the Central Bank of Kenya's (CBK) monetary policy response to the COVID-19 shock between March 2020 and early 2021. This analysis takes into account the various interventions undertaken at the directive of and on information from the Monetary Policy Committee (MPC) reports, Central Bank of Kenya (CBK) press releases and World Bank and International Monetary Fund assessments: from its series of policy interest rate reductions and central bank rate cut, credit-weighted, and an exceptionally large loan restructured, right through its extensive digital finance initiatives and loan restructuring facility. Each intervention is then viewed in relation to Keynesian analysis as well as models from credit-rationing and financial fragility theories. The results show that the response was rapid and broadly stabilizing, anchoring inflation expectations and preventing an acute banking crisis. However, transmission through the credit channel had been erratic, the reduction in the CRR was shallow since sector liquidity was already abundant, and the high level of loan moratorium (which touched over 57% of the total loans in February 2021) imposed an overhang of debt restructuring necessitating the additional year of regulatory forbearance. The review concludes by extracting a year of lessons for future shocks, along with reforms at the institution level, with the intention of increasing Kenya’s monetary policy instruments toolbox.

KEYWORDS: Monetary Policy, Central Bank of Kenya, Covid-19, Credit Channel, Loan Restructuring, Macroprudential Policy.

1. INTRODUCTION

The COVID-19 pandemic presented monetary authorities globally with a shock that was simultaneously a demand shock, a supply shock, and a financial-stability shock. Kenya recorded its first confirmed case on 13th March 2020, and within days the CBK had begun deploying an emergency policy package spanning interest-rate policy, funds management, prudential forbearance, and payments-system regulation. Like much of the world's monetary policy response that was defined by expansionary interest rate policy, particularly by the Federal Reserve, European Central Bank, and central banks of comparable emerging markets in a rapid and condensed period, Kenya's response was constrained by its properties as a bank-dominated, semi-dollarized frontier financial system with a recent past of interest-rate intervention.

This review addresses a focused but still significant question: whether the CBK's COVID-19 policy package achieved its stated objectives of preventing the pandemic from growing into a domestic financial crisis, while preserving price stability, and at what cost. The analysis intentionally excludes primary data collection, regression analysis, or hypothesis testing, providing instead a logically organized critique of primary and secondary data sources, predominantly from the Central Bank of Kenya Monthly Monetary Policy Committee reports and statements, IMF Article IV and RCF publications, World Bank Kenya Economic Updates, and contemporary newspaper reports on financial and economic activity, informed by well-grounded, theory-driven monetary and banking principles.

2. COVID-19 and Kenya's Macroeconomic Problems

The pandemic met an economy already on a more moderating but acceptable growth trajectory, having grown 5.4 percent in 2019, after its previous year's policy of interest rate capping law was revoked in November 2019, which had since 2016 limited credit intermediation (CBK, 2020). The shock transmitted through Kenya via three principal channels. First, a sharp contraction in trade- and travel-intensive services: containment measures curtailed tourism, transport, hospitality, and education activity, with the second quarter of 2020 recording an estimated 5.5 percent year-on-year GDP contraction, the sharpest quarterly decline in Kenya's recent statistical record. For the full year, the Kenya National Bureau of Statistics ultimately recorded a 0.3 percent contraction in real GDP for 2020 — modest by international comparison, and cushioned substantially by strong agricultural output and the continued expansion of information and communication services, but still the first annual contraction in nearly three decades (Kenya National Bureau of Statistics, 2021; World Bank, 2021).

Second, the external sector absorbed a terms-of-trade and travel-receipts shock. Urban crude oil prices collapsed from roughly USD 63.6 per barrel in October 2019 to USD 17.6 per barrel in April 2020, which paradoxically narrowed Kenya's oil-import bill and helped contain the current account deficit; travel-services receipts and horticultural exports, however, both declined markedly. On the other hand, money sent back to Kenya by people living abroad was surprisingly stable throughout this period. The Kenya shilling was also relatively stable against the US dollar compared to countries in the region and major currencies. This was supported by foreign exchange reserves of USD 7.74 billion, which were enough to cover imports for 4.64 months (CBK, 2020), a stability that stands out against the broader vulnerability of Kenya's balance of payments to exchange-rate volatility documented elsewhere (Omari & Kuso, 2025).

Third, and most consequential for monetary policy design, the shock generated acute stress in the banking and household credit markets. The number of loans relative to total loans was already high at 12.3 percent in October 2019, but it rose to 13.1 percent by April 2020 and reached a 20-year high by the third quarter of the year. This happened because borrowers in trade, real estate, and manufacturing could not repay their loans. At the time, the number of new loan applications and approvals went down sharply. Simultaneously, the value of new loan applications and approvals fell sharply, with household-sector loan applications down 42.9 percent and services-sector applications down 40.9 percent relative to pre-pandemic levels — evidence of both weakened credit demand and tightened supply-side rationing.

These pressures fed directly into the fiscal accounts: the fiscal deficit widened to an estimated 8.2 percent of GDP in FY2019/20, from a pre-pandemic budget target of 6.0 percent, while public debt rose to 65.6 percent of GDP by June 2020 from 62.4 percent a year earlier (World Bank, 2020), reflecting the sharper guns-versus-butter trade-offs that came to define Kenya's national budget over 2020–2025 (Christine & Kuso, 2026). This fiscal deterioration, financed partly through an IMF Rapid Credit Facility disbursement of USD 739 million approved in May 2020 (International Monetary Fund [IMF], 2020) and a subsequent USD 2.34 billion Extended Credit Facility/Extended Fund Facility arrangement in April 2021 (IMF, 2021), reduced the government's ability to spend money to support the economy.

3. Monetary Policy Approaches Adopted by the CBK

The CBK's response can be organized into five clusters of measures, most announced or activated between mid-March and end-April 2020 (CBK, 2020).

3.1 Policy-rate easing

Having already lowered the Central Bank Rate (CBR) from 9.00 to 8.50 percent in November 2019 and to 8.25 percent in January 2020 in response to below-potential growth, the MPC convened an out-of-cycle meeting on 23 March 2020 and cut the CBR further to 7.25 percent, followed by an additional cut to 7.00 percent at a special meeting on 29 April 2020 — a cumulative 125-basis-point reduction across the two pandemic-specific meetings (Table 1).

The Committee explicitly reconvened within weeks of each decision, a materially more frequent cadence than its standard bi-monthly schedule, indicating the elevated uncertainty of the period.

Table 1. CBK Monetary Policy Committee decisions, November 2019–April 2020.

25 Nov 2019	9.00%	8.50%	Interest-rate capping law repealed (Nov 2019), restoring price-based credit rationing.
27 Jan 2020	8.50%	8.25%	Continued accommodative stance; economy assessed to be operating below potential.
23 Mar 2020	8.25%	7.25%	CRR cut from 5.25% to 4.25% (releasing ~KES 35.2 billion); banking-sector loan restructuring framework announced; mobile-money fee waivers.
29 Apr 2020	7.25%	7.00%	REPO tenor extended from 28 to 91 days; MPC reconvened within a month to reassess pandemic impact.

3.2 Liquidity and Cash Reserve Ratio measures

In addition to lowering its rate, at the March meeting it lowered the ratio of funds kept voluntarily at the CBK (the cash reserve ratio) to 4.25 percent from 5.25 percent– this released over KES35.2bn to help banks support customers with pandemic-related debt. Furthermore, the maximum tenor of Reverse Repurchase Agreements was also extended from28to91days – making it easier for banks to access longer-tenored liquidity without having to sell off assets against government securities (CBK, 2020)

3.3 Loan restructuring and regulatory forbearance

The most consequential intervention, in terms of balance-sheet scale, was the emergency loan-restructuring framework announced on 18 March 2020. Banks were permitted to extend repayment periods, grant principal or interest moratoria, and waive fees for borrowers in good standing as of 2 March 2020, without the restructured facilities being reclassified as non-performing or requiring additional provisioning — a temporary suspension of ordinarily strict prudential classification rules. Table 2 traces the scale of this programme, which grew from KES 273.1 billion (9.5 percent of the loan book) by end-April 2020 to a peak of KES 1.70 trillion — 57 percent of the entire banking sector's gross loan book — by February 2021, before the emergency measures formally expired on 2 March 2021 and were succeeded by a further three-month regularisation window for arrears (CBK, 2021).

Table 2: Evolution of COVID-19 Loan restructuring (April 2020 – End-2022) "Sources: Central Bank of Kenya press releases and news articles from financial-related press media such as Standard media (2020) Kenyan wallstreet (2021) and Business Daily Africa (2023)"

End April 2020	KES 273.1 billion	9.5%	~KES 2.8 trillion
End June 2020	KES 844.4 billion	~29.1%	~KES 2.9 trillion
End Oct 2020	KES 1.38 trillion	46.5%	~KES 2.9 trillion
End Feb 2021 (peak)	KES 1.70 trillion	57%	~KES 3.0 trillion
End Feb 2021 (outstanding)	KES 569.3 billion	19%	—
End 2022 (outstanding)	~KES 330 billion	~9%	—

3.4 Digital-finance and payments measures

On 16 March 2020, CBK worked with commercial banks and mobile-money operators to eliminate transaction charges on mobile-money transfers below KES 1,000 and on transfers between bank accounts and mobile wallets, and raised the daily mobile-money transaction limit from KES 70,000 to KES 150,000. These measures, aimed explicitly at discouraging the physical handling of cash, produced a rapid uptake: more than 1.6 million additional customers began using mobile-money channels within weeks, concentrated in the sub-KES-1,000 transaction band that already accounted for over 80 percent of mobile-money volumes (CBK, 2020).

3.5 External and fiscal-monetary coordination

These domestic policy actions at the CBK were complemented by external funding that effectively facilitated domestic monetary policy: (i) external financing (IMF Rapid Credit Facility of $739 million was provided in May 2020 at the height of BOP and reserve adequacy concerns) prevented the need for a more restrictive monetary policy, and a further IMF Extended Credit Facility/Extended Fund Facility loan ($2.34 billion approved in April 2021) anchored the medium-term adjustment path (IMF, 2020 and 2021).

4. Critical Evaluation of the Measures

4.1 Transmission through the interest-rate and credit channels was uneven

Although the interest rate reductions in Kenya's monetary policy passed through quickly to the price of credit (average commercial bank lending interest rate declined to 11.9 percent in April 2020 from 11.9 percent in October 2019, and interest rate spreads tightened slightly), quantitative transmission was uneven across t sectors. Twelve-month private sector credit, while growing at an annual rate of 9.0 percent by April 2020 (from 6.6 percent in October 2019), witnessed a sharp bifurcation in activity. Credit to the manufacturing sector expanded by 20.1 percent and credit to consumer durables expanded by 19.6 percent; in contrast, loans applied for by both households and the services sector - the worst affected sectors by containment measures – shrank by more than 40 percent (CBK, 2020).

This pattern is in line with credit rationing theories by Stiglitz and Weiss (1981), where lending to distressed sectors is characterized not by increased credit price but by quantity rationing, on behalf of banks, preferring to direct new lending to larger, identifiable, safe borrowers due to fundamental uncertainties about the creditworthiness of borrowers (Ombewa & Kuso, 2026). A CBR cut, however large, cannot by itself overcome this adverse-selection dynamic; it lowers the cost of funds for banks without resolving the information asymmetry that determines who receives credit, consistent with broader evidence that monetary policy's link to private capital formation across Sub-Saharan Africa is mediated by such credit-market frictions (Gachunga Muhia, Kuso, & Muhia, 2019).

4.2 The CRR cut was of limited binding significance

The headline CRR reduction, while symbolically important, is open to the criticism that it was not a binding constraint on bank behavior. Kenyan commercial banks entered the crisis with an average liquidity ratio of 51.2 percent — more than double the 20 percent statutory minimum — and this ratio remained essentially unchanged through April 2020 (CBK, 2020). A sector already holding large precautionary liquidity buffers, much of it in government securities, was unlikely to be materially constrained by a 100-basis-point reduction in reserve requirements releasing KES 35.2 billion against a loan book of roughly KES 2.8 trillion. This observation echoes the wider "lazy banking" critique of the Kenyan financial system: structural incentives — the risk-free, liquid, and historically well-remunerated character of government paper — have long encouraged banks to hold a portfolio tilted toward sovereign debt (Tobin, 1969; VanHoose, 2007), and a crisis-driven liquidity injection does little to alter that portfolio allocation unless it is accompanied by measures that specifically de-risk private lending, such as credit guarantees. The CRR cuts thus make sense best as a liquidity and small margin-enhancing tool rather than one that has been instrumental in expanding credit in favor of stressed entities.

4.3 Loan restructuring averted an acute crisis but built a forbearance overhang

The loan restructure framework was undoubtedly successful at meeting its immediate policy objective to avert possible wholesale defaults of loans and consequently avert an emerging banking sector crisis, reflected in the moderate uptick in nonperforming loans ratio (NPL) from 12% to 14% despite economic recession, with over 50 percent of loans outstanding under revised terms in a loan book of over 2.8 trillion, which was better performance than historical standards would have suggest. Nevertheless, the program introduced certain hitherto unseen costs to this outcome, and these are not clearly evident in headline NPL trends. Firstly, the suspension of general loan loss provisioning for restructured loans up to one year had the effect of deferring, not eliminating, any recognition of credit losses that, when rolled back from March 2021 to the end of 2022 and, even from the outstanding restructured loan figure of Ksh 569.3 billion to approx. 330 billion, almost 9% of the Kenyan banks' loan book, had to be restructured yet again nearly three years after the outbreak of the shock, a pattern consistent with evidence that provisioning choices materially shape the reported financial performance of Kenyan commercial banks (Andesia & Kuso, 2025b).

Such an eventuality of ‘extend and pretend,’ and development of zombie lending, was foreseen due to the flexibility in deferring recognition of losses, evident in prior European experiences following 2008. Second, there were documented reports of abuse of flexibility related to capitalization of interest in the restructured schemes by some Banks in the financial sector, raising costs for borrowers who were neither clearly informed, leading to consumer concerns. This situation signaled supervisory gaps regarding proper disclosure on loan restructuring Terms (Business & Human Rights Resource Center, 2020). CBK emergency measures, however, focus only on prudential classification of loans but leave individual restructuring terms to the individual discretion of banks, with few standard disclosures and thus no supervisory mechanisms put in place against malpractices.

4.4 The digital-finance channel outperformed conventional instruments

A CBK intervention that triggered the quickest and most widespread behavior change of all was the waivers of the mobile-phone-based money transmission and adjustment in mobile-banking limits that were implemented by CBK, which prompted more than 1.6 million additional active users to enroll on mobile platforms within weeks.

With already established popularity in M-pesa and similar services in Kenya before COVID-19, which penetrated more than 85% of adults, this measure was effective and unprecedented as it circumvented the usual collateral and information obstacles met within the banking sector by reducing the cost of payment transactions in general instead of focusing on the price or availability of credit, strengthening the argument of using Kenya’s existing digital-payments ecosystem as a formal part of its macro and financial tools, in line with evidence that mobile banking access has measurable welfare effects for Kenyan households (Odoyo Olwa & Kuso, 2025a), as elaborated later in Section 5.

4.5 Monetary accommodation operated under a narrowing fiscal-space constraint

It is important to note that the CBK did not implement its monetary stimulus program in isolation. The fiscal deficit expanded to 8.2 percent of GDP by June 2020 (World Bank, 2020), and the debt-to-GDP ratio increased from approximately 55 percent in 2019 to 65.6 percent in 2020, thereby increasing the government's domestic funding requirements at a time when monetary policy intended to improve private sector credit supply. The expanded issuance of government securities provided a less risky alternative to corporate lending, which monetary policy sought to stimulate. As a result, simultaneous expansions in monetary stimulus and fiscal debt financing risked crowding out private sector credit, strengthening the preference for safe assets such as government securities. Although the Fund's emergency program and subsequent funding helped reduce this trade-off by providing external resources to supplement domestic debt, it did not completely resolve the basic tension, echoing the wider observation that external financing can substitute for, but not fully replace, domestic revenue mobilization in Kenya's fiscal position (Moses & Kuso, 2025).

5. Lessons for Future Economic Disturbances

Several generalizable lessons emerge from this review.

First, under an "extreme of concentration on a bank-dominated economy with pervasive credit rationing", traditional interest rate policy has a fundamentally constrained effect; the desired set of a contingent toolkit at the end of this process should combine a given "action on rates" with "sectoral credit risk-sharing policies"-partial credit guarantees for micro, small, and medium enterprises- instead of leaving it to "interest rates to reorient the sector allocation of the loan supply", especially for the sectors the most hit by a shock.

Second, liquidity-ratio and reserve-requirement instruments have their impact only to the degree that the restriction which they slacken is restrictive; since Kenyan banks normally manage to maintain levels of liquidity in excess of the minimum prescribed, any use of these devices to accommodate other shock shocks should take account of actual holdings of excess liquidity instead of statutory minimum, and be integrated with tools which influence trade offs between private borrowing and treasury bills.

Thirdly, prudential forebearance, used successfully by many countries to arrest a deluge of defaults in 2020-21, proved more easily deployed in as "take" – with an unwind period taking two years of 2022-23, and a lasting overhang that warrants its structure include automatic expiry clauses, gradual building of impairment provisions, and monitoring of restructuring outcomes by an independent body - the time it will take to manage any exit to a later date and do it post-hoc, not in ex Ante.

Fourth, Kenya's mobile-money network performed as a cheap, deployable real-time payments system capable of disburse credit (or cash via agents) in the context of crisis-era assistance, highlighting that policy for digital payments needs a formal place as on-standing feature of our approach to crises.

Fifth, monetary accommodation cannot be evaluated independently of the fiscal financing environment in which it operates; future shock-response planning should explicitly represent the interaction between expansionary monetary policy and the government's domestic borrowing program, to avoid a configuration in which fiscal financing needs blunt the intended effect of monetary easing on private credit.

6. Policy Recommendations

Drawing lessons from the above points, the following will increase Kenya's ability to face any shocks that may arise in the future:

1. Have a stand-by contingent monetary policy which has clear thresholds for triggering and a menu of rate, liquidity andmacro-prudential policy tools so that, if a need arises, the CBK will respond as it did in March 2020 without the need to custom-design tools in the time of the crisis
2. Build countercyclical capital and liquidity buffers during upswings specifically so that reserve-requirement relief has real bite in a downturn, rather than releasing liquidity into a banking sector that is already liquidity-abundant.
3. Bury optional sunset clauses in future loan restructure/forbearance directives along with phased drawdowns when designing these measures, mandate standardized borrower disclosures in future directives, and include independent scrutiny of the terms by supervisors to remove the consumer protection hole in paragraph 4.3 above.
4. Introduce targeted, partially guaranteed credit facilities for micro, small, and medium enterprises and other sectors prone to acute demand collapse, to augment rather than rely solely on economy-wide rate cuts for redirecting credit to the most affected borrowers, addressing the credit-access constraints documented among Kenyan micro-enterprises (Ingado Aluvisia & Kuso, 2025).
5. Formally integrate digital payments and mobile-money into the CBK's crisis-response kit with pre-negotiated and clearly defined protocols to adjust fees and transaction limits that can be swiftly deployed immediately following a shock.

6. Strengthen high-frequency and nowcasting data capacity at the CBK and Kenya National Bureau of Statistics, to shorten the lag between the onset of a shock and the data needed to calibrate policy, lessening reliance on the kind of rapid, largely qualitative judgment that characterized the March 2020 response.
7. Deepen coordination among the CBK, the National Treasury, and the Public Debt Management Office to ensure that the domestic government securities financing program accompanying any future fiscal expansion is sequenced to avoid crowding out the private-credit expansion that monetary easing is intended to support.

7. CONCLUSION

The Central Bank of Kenya's response to the COVID-19 shock was swift, multi-instrument, and, on the central metric of avoiding an acute domestic banking crisis, broadly successful. A cumulative 125-basis-point policy-rate cut, a Cash Reserve Ratio reduction, extended liquidity facilities, an unprecedented loan-restructuring program covering the majority of the banking sector's loan book, and rapid digital-payments measures together cushioned households, firms, and banks through the most acute phase of the shock. At the same time, inflation stayed anchored within target, and the exchange rate proved comparatively stable — a comparatively favorable outcome set against the more volatile inflation dynamics experienced by regional peers over the same period (Orina & Kuso, 2025). However, further study found the transmission of the crisis into domestic prices happened not through the policy-driven (interest rates) mechanism, which is the central concept of monetary policy, but rather due to financial sector tolerance and another more novel means of transaction - a system of digital payments which existed apart from the main rate transmission system. The unevenness of credit-channel transmission, the limited bindingness of the CRR cut given already-ample sector liquidity, the multi-year unwinding of the restructuring overhang, and the tension between expansionary monetary and fiscal financing all point to structural features of Kenya's financial system — rather than merely the severity of the 2020 shock — that will constrain the effectiveness of conventional monetary policy in any future crisis unless addressed through the institutional reforms proposed above.

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