Cytonn Note on the Monetary Policy Committee Meeting for January 2017

The Monetary Policy Committee (MPC) is set to meet on Monday 30th January 2017 to review the prevailing macro-economic conditions and give direction on the Central Bank Rate (CBR). In their previous meeting, held in November 2016, the MPC maintained the CBR at 10.0% citing (i) the stability of the currency despite widespread volatility in the global market following the conclusion of the US elections, (ii) high forex reserves level at 4.8 months of import cover, as well as the IMF facility, of which the Central Bank of Kenya (CBK) could tap into in case of economic shocks, (iii) stable inflation which remained within the government annual target of between 2.5% - 7.5%, and (iv) the stability of banking system in terms of liquidity distribution with the average liquidity ratio for commercial banks at 43.6% in October, from 41.9% in August.

However, the MPC noted that (i) there was no evidence that the slowing private sector credit growth, which was attributable to tightened risk management measures by banks as opposed to monetary policy, was having a negative impact on the economy, and (ii) the available data at that time was inadequate to make a conclusion as to the impact of the Banking (Amendment) Act, 2015 on the economy.

We analyse the macro-economic indicators since the November 2016 MPC meeting as summarized in the table below:

Key Macro-Economic Indicators – Kenya					
Indicators	**Expectations at start of 2016/2017 Fiscal Year**	**Experience since the last MPC meeting on 28th November 2016**	**Going forward**	**Probable CBR Direction (Last MPC Meeting)**	**Probable CBR Direction (This month)**
Government Borrowing	Government expected to borrow Kshs. 229.6 bn domestically for the 2016/2017 financial year and Kshs 462.3 bn from the foreign market	The government was ahead of its domestic borrowing target having borrowed Kshs. 164.0 bn against a target of Kshs 132.5 bn (Kshs 170.0 bn if revised). The Government is in the process of revising the domestic borrowing target to Kshs 294.6 while reducing the foreign borrowing to Kshs 287.6 bn (Kshs 45.8 bn borrowed so far)	The government is currently ahead of its domestic borrowing target but the deficit in foreign borrowing (9.9% of the total target borrowed so far, 15.9% if revised) may serve as a strain on the government and exert upward pressure on interest rates. However, the reduced credit to private sector may make it easier for government to bridge the foreign borrowing deficit through local domestic borrowing	**Neutral**	**Neutral**
Revenue Collection	KRA to meet the revenue collection target	KRA is behind their H1 target for the fiscal year, having collected Kshs 591.7 bn, representing 39.4% of the total tax revenue target. The government is in the process of revising the revenue collection target downwards by 2.9%, which currently stands at 1.5 tn	Given the Interest Rate Caps, we expect subdued earnings by the banking sector. Given that the government is behind on revenue collection, we expect government not to meet its target	**Negative**	**Negative**
Inflation	Below the government upper bound of 7.5%	Decreased to 6.4% in the month of December from 6.7% in November, despite a rise in food prices	We expect Inflation to increase marginally but to average within the government's target range of 2.5% - 7.5%	**Neutral**	**Neutral**
Exchange rate (USD/Kshs)	To remain stable supported by dollar reserves and improved foreign exchange inflows through improved	The shilling has depreciated by 1.9% against the dollar since the last meeting and has recently been under pressure due to the global	We expect the currency to depreciate against the dollar driven by (i) global strengthening of the dollar as the Fed plans to increase the pace of rate hiking in 2017, and	**Neutral**	**Neutral**

	diaspora remittances and tea exports	strengthening of the dollar following the Fed rate hike	(ii) recovery of the global oil prices. However, the CBK has sufficient reserves (equivalent to 4.5 months of import cover) to support the shilling in the short term		
Banking Sector and Private Sector Credit Growth	We expect improved governance, following the closure of Imperial and Dubai Banks and consolidations within the banking industry. We also expected Private Sector credit growth to average around the government set a target of 18.0%	Banks posted positive Q3' 2016 results, with weighted average growth in core EPS of 15.1%, above expectation of 12.5%. Meanwhile, Private sector credit growth slowed to 4.6% for the 15th consecutive month in October	Given that the policy rate is currently linked to loan pricing, any adjustments on the rate will impact banking sector profitability and private sector credit growth as banks try to fit the private sector within the 4.0% risk margin While it is expected that private sector credit growth will continue to slump, it is yet to be attributed to the interest rate caps	**Neutral**	**Neutral**
Liquidity	Liquidity expected to improve given high maturities of government securities	The money market has been tight lately, with the interbank rising from as low as 4.2% in mid-December, averaging 7.7% in January	We expect the liquidity tightness in the money market to persist in the medium term. However, the CBK is participating actively in the reverse repo market in a bid to ease the liquidity situation in the market	**Neutral**	**Neutral**

Conclusion

Of the six key indicators, five are neutral and one negative, with all the indicators maintaining their position from the last MPC meeting.

We are of the view that MPC will maintain the CBR at 10.0%.