Cytonn Note on the 3rd April 2024 Monetary Policy Committee (MPC) Meeting

The Monetary Policy Committee (MPC) is set to meet on Wednesday, 3rd April 2024, to review the outcome of its previous policy decisions and recent economic developments, and to decide on the direction of the Central Bank Rate (CBR). In their previous meeting held on 6th February 2024, the committee noted that they would closely monitor the impact of the policy measures taken, as well as developments in the global and domestic economy, and stood ready to reconvene earlier if necessary. Additionally, the MPC decided to raise the Central Bank Rate by 0.5% points to 13.0%, from 12.5% citing the need to contain the depreciation of the Kenyan Shilling as well as inflationary pressures which came in at 6.9% in January 2024, remaining in the upper bound of the preferred CBK range of 2.5%-7.5%. This was contrary to our expectation for the MPC to retain the CBR rate at 12.5%, with our view having been informed by:

i. Inflation had remained within the bank's target of 2.5% -7.5% for the sixth consecutive month on account of the relatively stable food prices being experienced in the country at the time as a result of the favorable weather conditions. Given that one of the main goals of monetary policy is to ensure price stability, we believed that the stable inflation rate which came in at 6.3% in the month of February would not exert pressure on the MPC to tighten further the central bank rate, and,
ii. The need to support the economy by adopting an accommodative policy that would ease financing activities. The Purchasing Managers Index (PMI) had for the last 2 months at the time remained below the 50.0 no-change threshold, with the January 2024 PMI recording an increase to 49.8 from 48.8 recorded in December 2024, an indication of improving but still contracting the business environment. An additional hike in the CBR rate, in our view would curtail economic growth given the constrained business environment.

The Monetary Policy Committee noted that the current account deficit is estimated at 3.9% of GDP in 2023, down from 5.0% in 2022, and is projected at 4.0% of GDP in 2024, reflecting the expected recovery in imports, resilient remittances, and expected rebound in agricultural exports. Goods exports declined by 2.2% in 2023 compared to an increase of 9.3% in 2022. Additionally, the Monetary Policy Committee noted that Goods exports declined by 2.2% in 2023 compared to an increase of 9.3% in 2022. The decline in exports in 2023 was across several categories, except food, chemicals, and manufactured goods exports which increased by 0.8%, 2.8%, and 11.3% respectively. The increase in manufactured export receipts reflects strong regional demand. Imports declined by 10.6% in 2023 compared to a growth of 7.3% in 2022, reflecting lower imports across all categories, except food and crude materials. Tourist arrivals improved by 30.7% in 2023 compared to 2022, and were 19.3% higher in December 2023 compared to December 2022. Remittances increased by 4.0% to USD 4,190 million in 2023 from USD 4,028 million in 2022.

Additionally, The Committee noted the ongoing implementation of the FY2023/24 Government Budget, which continues to reinforce fiscal consolidation. Notably, total revenue collected as at the end of February 2024 amounted to Kshs 1,424.9 bn, equivalent to 55.3% of the revised estimates of Kshs 2,576.8 bn for FY'2023/2024 and is 82.9% of the prorated estimates of Kshs 1,717.8 bn. The total expenditure amounted to Kshs 2,438.5 bn, equivalent to 57.0% of the revised estimates of Kshs 4,281.6 bn, and is 85.4% of the prorated target expenditure estimates of Kshs 2,854.4 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 808.6 bn, equivalent to 59.4% of the revised estimates of Kshs 1,360.1 and 89.2% of the prorated estimates of Kshs 906.7 bn,

Below, we analyze the trends of the macro-economic indicators since the February MPC meeting, and how they are likely to affect the MPC decision on the direction of the CBR:

Cytonn Report: Macroeconomic Indicator Trends and Our Expectation				
Indicators	Experience since the last MPC meeting in February 2024	Our Expectation Going Forward	CBR Direction (February 2024)	Probable CBR Direction (April 2024)

Government Revenue Collection	• Total revenue collected as at the end of February 2024 amounted to Kshs 1,424.9 bn, equivalent to 55.3% of the revised estimates of Kshs 2,576.8 bn for FY'2023/2024 and is 82.9% of the prorated estimates of Kshs 1,717.8 bn. Cumulatively, tax revenues amounted to Kshs 1,374.0 bn, equivalent to 55.1% of the revised estimates of Kshs 2,495.8 bn and 82.6% of the prorated estimates of Kshs 1,663.9 bn, • The government has been unable to meet its prorated revenue targets for the eight months of the FY'2023/2024, mainly on the back of the tough economic situation exacerbated by the elevated inflationary pressures that despite decreasing by 0.6% points in February to 6.3% from the 6.9% recorded in January, still remains on the upper bound of the CBK target of within a range of 2.5% -7.5%. Additionally, the revenue collection continues to be impeded by the high cost of living, despite the improvement in the business environment with the PMI coming in at 51.8 in February, above the contraction zone. In light of this, the government is yet to fully benefit from the strategies put in place to improve revenue collection such as expanding the revenue base and sealing tax leakages, and suspension of tax relief payments. We believe that the performance of revenue collection in the coming months will be largely determined by how soon the country's business environment stabilizes, which is expected to be supported by the ongoing strengthening of the Shilling having gained by 15.3% against the dollar on YTD basis.	• In the short term, we expect the revenue collections to improve towards the prorated targets given the now recovering business environment, on the back of easing inflationary pressures as a result of high fuel and electricity prices, coupled with the sustained appreciation of the shilling against the dollar which continue to relieve pressure on the economic environment • The government's continued efforts to broaden the tax base will also lead to increased tax revenue collection, evidenced by the provisions in the current Finance Act Among the key provisions in the Act included an increase of the VAT on Petroleum from 16.0% to 8.0%, introduction of a higher personal income tax rate of 35.0% on the income of individuals earning above Kshs 500,000.0 per month from the then existed 30.0%, introduction of tax of 3.0% on income derived from the transfer or exchange of digital assets, and an increase in turnover tax to 3.0% from the then existed 1.0%. As such, we expect the tax collections to increase in the long-term and thus boost the government's efforts to meet it revenue collection target, we, however, are wary of the negative impact these new taxes may have on the revenue collection • Nevertheless, given the improving general business environment which is underpinned by the appreciation of the Kenyan shilling, easing liquidity in the money market, and easing inflationary pressures, we expect these to support the tax revenue, but remain wary of the unpredictable tax regime that may weigh down the collections.	**Neutral**	**Neutral**
Government Borrowing	• The government, as at 26th March 2024, was 10.4% behind its prorated borrowing target of Kshs 347.0 bn having borrowed Kshs 383.0 bn of the total borrowing target of Kshs 471.4 bn. The government has domestic maturities worth Kshs 378.0 bn and will have to borrow Kshs 144.3 bn monthly to meet the upcoming domestic maturities and the budget deficit in the FY'2023/2024 • Total Borrowings as at the end of February 2024 amounted to Kshs 1,019.8 bn, equivalent to 59.9% of the revised estimates of Kshs 1,701.7 bn for FY'2023/2024 and are 89.9% of the prorated estimates of Kshs 1,134.4 bn. The cumulative domestic borrowing of	• Kenya's rising debt sustainability remains a significant concern with the government's borrowing appetite remaining high given the subdued economic environment coupled with an ever-present fiscal deficit. While credit risk was significantly reduced with the Eurobond buyback in February, the debt servicing costs are expected to remain high with the payment on the remaining part of the USD 2.0 bn Eurobond This has led to Credit rating agencies such as Moody's Credit Rating Agency, S&P Global Rating and Fitch to downgrade their outlook of Kenya. Notably, Kenya's latest rating by moody was at B3 for both local issuer and foreign currency	**Negative**	**Negative**

	Kshs 851.9 bn comprises of Net Domestic Borrowing Kshs 471.4 bn and Internal Debt Redemptions (Rollovers) Kshs 380.5 bn. • Kenya has continued to receive financing from the World Bank and other bilateral lenders such as the International Monetary Fund (IMF). Recently, the Executive Board of the IMF announced that it had concluded the 2023 Article IV consultation with Kenya together with the sixth reviews and augmentations of access of USD 941.2 mn (Kshs 151.3 bn) under the EFF/ECF arrangement, and the first review under the 20-month Resilience and Sustainability Facility (RSF) arrangement, approved in July 2023. Notably, the Board's decision allows for the immediate disbursement of USD 624.5 mn (Kshs 100.4 bn) under the EFF/ECF arrangements - which includes an augmentation of access of USD 310.6 mn (Kshs 50.0 bn) - and brings total disbursements under the EFF/ECF arrangements to USD 2.7 bn (Kshs 431.1 bn). The approval also allows for an immediate disbursement of USD 60.2 mn (Kshs 9.7 bn) under the RSF arrangement, taking the total disbursement under this program to USD 60.2 mn (Kshs 9.7 bn).	issuer an indication of a high credit risk		
Inflation	• Year on year (y/y) inflation rate for March 2024 eased by 0.6% points to 5.7%, from the 6.3% recorded in January 2024. The headline inflation for December 2023 was majorly driven by increase in prices of commodities in the following categories, transport; housing, water, electricity, gas and other fuels; and food and non-alcoholic beverages by 10.8%, 8.4% and 6.9%, respectively. • Notably, the significant increase of Housing, Water Electricity and gas index by 8.4% year on year was mainly driven by the decrease in prices of Electricity of 50kWh and 200kWh by 11.0% and 9.3% respectively, coupled with a 0.5% decrease in the price of kerosene per litre. • Petrol, Diesel and Kerosene prices decreased by Kshs. 1.0 each, to retail at Kshs 206.4, Kshs. 195.5 and Kshs. 193.2 per litre respectively, for the period between 15th February 2024 to 14th March 2024, as well as the high taxation of petroleum products as provided in the finance Act 2023. • Notably, February's overall headline inflation was back on the decline after	• We expect inflation rates to remain elevated but within the CBK's target range of 2.5% - 7.5% supported by the current fiscal stance by the Monetary Policy Committee, having increased the Central Bank Rate by 0.5% points in February 2024 to 13.0%, after the rate remained constant at 12.5% for two consecutive meetings. Additionally, the recent appreciation of the Kenyan shilling against major currencies is also expected to keep inflationary pressures in the country down as manufacturers get relief with the lower importation costs of inputs	**Neutral**	**Positive**

	increasing for the first time in three months in January, however, it has remained within the Central Bank of Kenya (CBK) target range of 2.5% to 7.5% for the eighth consecutive month.			
Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has appreciated significantly by 17.8% against the US Dollar to Kshs 131.8 as at 29th March 2024, from Kshs 160.4 recorded on 6th February 2024 mainly attributable to eliminated credit risk from the Eurobond buyback • However, the Forex Reserves have decreased by 2.2% to USD 7.0 bn (equivalent to 3.8 months of import cover) as of 26th March 2024 from USD 7.1 bn (equivalent to 3.7 months of import cover) recorded in 6th March 2024. Notably, the forex reserves are below the statutory requirement of maintaining at least 4.0 months of import cover and lower than the EAC region's convergence criteria of 4.5 months of import cover	• We expect the Kenyan Shilling to be supported by Diaspora remittances standing at a cumulative USD 4,329.7 mn in the 12 months to February 2024, 7.5% higher than the USD 4,026.2 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the February 2024 diaspora remittances figures, North America remained the largest source of remittances to Kenya accounting for 56.0% in the period, and, • Additionally, the shilling performance and strength is expected to be supported by the sufficient forex reserves currently at USD 7.1 bn (equivalent to 3.8-months of import cover), which is slightly below the statutory requirement of maintaining at least 4.0-months of import cover. Moreover, tourism receipts which came in at USD 333.9 mn in 2023, a 24.6% increase from USD 268.1 mn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 30.7% to 192,000 in the 12 months to December 2023, from 161,000 recorded during a similar period in 2022.	**Negative**	**Positive**
GDP Growth	• Kenyan's economy recorded a 5.9% growth in Q3'2023, faster than the 4.3% growth recorded in Q3'2022, pointing towards a faster economic growth. The performance was driven by; i. The positive growth recorded in all sectors, with most sectors recording improved growth compared to Q3'2022, with Accommodation and Food Services; Agriculture, Forestry and Fishing; and Mining and Quarrying Sectors recording the highest growth improvements of 9.1% points, 8.0% points, and 5.6% points, respectively. Other sectors that recorded expansion in growth rate, from what was recorded in Q3'2022 were Financial and Insurance Services, Information and Communication and Real	• We expect Kenya's GDP to continue growing at a slower pace in line with the global economy trends. However, the economy will be supported by sustained recovery in sectors like accommodation and food services sector, as well as recent fiscal policies such as subsidizing costs of crucial farm inputs such as fertilizer that are expected to support growth in the agriculture sector, which remains to be Kenya's largest contributor to GDP, • The continued appreciation of the Kenya shilling has continued to support the business environment, by reducing the cost of imported inputs and decreasing the finance cost of the foreign currency denominated debts • Notably, the country's PMI for the month of February 2023 increased for the first time in four months months	**Neutral**	**Neutral**

	Estate sectors, of 5.1%, 2.7% and 2.2% points respectively; ii. The rebound of Agricultural Sector with Agriculture, Forestry and Fishing activities recording a growth of 6.7% compared to a contraction of 1.3% points in Q3'2022. However, the performance was a decrease of 1.0% points, from the growth of 7.7% recorded in Q2'2023. The positive growth recorded during the quarter was mainly attributable to sufficient rainfall experienced in the quarter under review resulting to increased agricultural production. Notably, during the quarter, production of key food crops and cash crops increased with a significant increase in the production of tea, vegetables and fruit during the quarter under review.	to 51.3, up from 49.8 in November, to move into the expansionary zone, an indication of an improved business environment in the country. Likewise, according to CEO's survey-November 2023 report, optimism regarding growth prospects for the Kenyan economy deteriorated due to input cost constraints.		
Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth continues to recover having grown by 13.9% in December 2023, attributed to strong credit growth in sectors such as; Finance and Insurance, Agriculture, Manufacturing and Transport and communication, of 41.6%, 18.5%, 18.4% and 16.2% respectively. Additionally, the number of loan applications and approvals remained strong, reflecting resilience in economic activities.	• We anticipate continued adoption of the risk-based pricing model in the banking sector to continue to unlock access to credit to individuals and businesses who were not captured by the previous frame works due to being considered too risky, • However, the increased government borrowing is expected to continue crowding out the private sector in the short term as seen by the weighted average yield for T-Bonds coming at 18.6% in the month of January effectively edging out majority of the corporate bonds currently in the trading in market • Additionally, banks have adjusted their lending rates in line with the CBR rate which was increased to 12.50% in December MPC meeting. This is expected to slow down the private sector credit demand	**Positive**	**Neutral**
Liquidity	• Liquidity levels in the money markets eased slightly, with the average interbank rate since the previous MPC meeting decreasing slightly by 0.02% points to remain relatively unchanged at 13.3% as of 26th March 2024, from, partly attributable to Government payments that offset tax remittances	• We expect liquidity in the money markets to be supported by the high domestic debt maturities that currently stand at Kshs 329.4 bn worth of T-bill maturities and Kshs 39.2 bn worth of T-bond maturities for FY'2023/2024.	**Positive**	**Positive**

Conclusion

Out of the seven factors that we track, three are positive, three are neutral and one is negative. Notably, most of the Central Banks of developed economies around the world have maintained elevated rates with the aim of anchoring inflation within their target ranges.

The main goal of monetary policy is to maintain price stability and support economic growth by controlling the money supply in the economy. We expect the MPC to maintain the Central Bank Rate (CBR) at the current rate of 13.00% with their decision mainly being supported by:

i. The ease in y/y inflation in March 2024 to 5.7%, from 6.3% recorded in January 2024 marking the seventh consecutive month that inflation has fallen within the CBK target range of 2.5%-7.5%. However, the risk lies on the back of reduced but still elevated fuel prices despite a decrease in global prices mainly on the back of high taxes. As such, we expect the MPC to maintain the CBR as the current monetary stance still transmits in the economy,

ii. The need to maintain the recent appreciation of Shilling and stabilize it from volatility as other Central Banks maintain high rates, is expected to remain a key factor in maintaining the CBR rate elevated. Since the last meeting, the Kenyan Shilling has appreciated significantly by 18.7% against the US Dollar to Kshs 135.1 as at 26th March 2024, from Kshs 160.4 recorded on 6th February 2024 mainly attributable to eliminated credit risk from the Eurobond buyback, as well as increased dollar supply in the market. As such, a decrease in the CBR rate would possibly reverse the gains by the Shilling or make it more volatile,

iii. The need to support the economy by adopting an accommodative policy that will ease financing activities. The Purchasing Managers Index (PMI) has for the first time in twelve months, come in above the 50.0 threshold, with the February 2024 PMI coming in at 51.3, an indication the business environment is finally in the expansionary zone. An additional hike in the CBR rate might curtail economic growth given the current macroeconomic and business environment, which cannot accommodate further hikes, and,

iv. There is also the need to give the new rates time to have further effect on the economy. While there have been some effects in the discussed metrics, more time would make the hiked rates much more effective.