Cytonn Note on the 5th December 2024 Monetary Policy Committee (MPC) Meeting

The Monetary Policy Committee (MPC) is set to meet on Thursday, 5th December 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 8th October 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 cut the CBR by 75.0 bps citing that its previous interventions successfully curbed inflation to below the midpoint of the CBK's target range, which came in at 2.7% in October 2024, supported by the exchange rate pressures, and lower fuel inflation. This was in line with our expectation for the MPC to lower the CBR rate, with our view having been informed by:

i. Rate cuts by global giant economies. In their last sitting on September 18th 2024, the US Federal Reserve announced their decision to cut its benchmark interest rate by 50.0 bps, to a range of 4.75%-5.00% from a range of 5.25%-5.50%. This followed the European Central Bank rate cut by 25.0 basis points to 3.5% from 3.75% earlier in the month,
ii. The continued stability of the Shilling against major currencies, despite the August rate cut in the CBR giving room for a moderate cut without reversing the Shilling's gain. Since the last meeting, the Kenyan Shilling had appreciated by 0.7% against the US Dollar to Kshs 129.2 as at 29th September 2024, from Kshs 130.1 recorded on 6th August 2024 mainly attributable to improved foreign reserves which are currently at 4.1 months of import cover, above the statutory requirement of 4.0 months cover, and,
iii. The need to support the economy by adopting a more accommodative policy that will ease financing activities. The Purchasing Managers Index (PMI) had come in below the 50.0 threshold, with the September 2024 PMI coming in at 49.7, an indication the business environment is in the contractionary zone. A cut in the CBR rate would help spur economic growth, increase money supply and improve business activities in the country.

The Monetary Policy Committee noted that the current account deficit is estimated at 3.8% of GDP in August 2024, up from 3.7% in August 2023, and is projected at 4.0% of GDP in 2024, despite the expected recovery in exports, resilient remittances, and expected rebound in agricultural exports. Additionally, the Monetary Policy committee noted that Goods exports increased by 8.8% in the 12 months to August 2024, compared to a similar period in 2023, reflecting a rise in exports of agricultural commodities and re-exports. The increase in exports in 2024 was across several categories, including tea and vegetable & fruits and agricultural re-exports, which saw respective increases of 3.9%, 14.1% and 73.5%. Imports increased by 3.8% in the twelve months to August 2024 compared to a similar period in 2023, mainly reflecting higher imports in machinery and transport equipment, crude materials and miscellaneous manufactures. Tourist arrivals improved by 21.0% in the twelve months to August 2024. Remittances increased by 12.7% to USD 4,644.5 million in the twelve months to August 2024 from USD 4,119.7 million in a similar period in 2023, and were 16.4% higher in the first 8 months of 2024, compared to a similar period in 2023.

Additionally, the Committee noted the ongoing implementation of the FY'2024/25 Supplementary Budget I, which is expected to lower the fiscal deficit to 4.3% of GDP, from 5.2% of GDP in FY'2023/24 hence continuing to reinforce fiscal consolidation. Notably, total revenue collected as at the end of October 2024 amounted Kshs 768.8 bn, equivalent to 29.2% of the revised estimates of Kshs 2,631.4 bn for FY'2024/2025 and is 87.7% of the prorated estimates of Kshs 877.1 bn. The total expenditure amounted to Kshs 1,032.6 bn, equivalent to 24.5% of the revised estimates of Kshs 4,207.9 bn, and is 73.6% of the prorated target expenditure estimates of Kshs 1,402.6 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 413.2 bn, equivalent to 31.6% of the revised estimates of Kshs 1,307.9 and 94.8% of the prorated estimates of Kshs 436.0 bn,

Below, we analyze the trends of the macro-economic indicators since the October 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 October 2024**	**Our Expectation Going forward**	**CBR Direction (October 2024)**	**Probable CBR Direction December 2024)**
Government Revenue Collection	• Total revenue collected as at the end of October 2024 amounted to Kshs 768.8 bn, equivalent to 29.2% of the revised estimates of Kshs 2,631.4 bn for FY'2024/2025, and is 87.7% of the prorated estimates of Kshs 877.1 bn. Cumulatively, tax revenues amounted to Kshs 696.7 bn, equivalent to 28.1% of the revised estimates of Kshs 2,475.1 bn and 84.4% of the prorated estimates of Kshs 825.0 bn, • The government was unable to meet its prorated revenue targets for the fourth consecutive month of the FY'2024/2025, attaining 87.7% of the revenue targets in October 2024, mainly on the back of the tough economic situation exacerbated by the elevated high credit cost in the country, with the commercial banks weighted average lending rates for the month of September 2024 coming in at 16.9% up from the 16.8% recorded in June. The cost of living remains elevated in the country, which continues to impede revenue collection despite an improvement in business environment with the PMI coming in at 50.4 in October 2024 from the 49.7 recorded in September 2024. 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. The coming months' revenue collection performance will largely depend on how quickly the country's business climate stabilizes. This stabilization is expected to be aided by the ongoing stability of the Shilling. Although it has depreciated marginally by 0.4% against the dollar in the since the last meeting in October, it remains stable. Additionally, the easing inflationary pressures, and, an ease in the monetary policy in the country, with the Monetary Policy Committee (MPC) announcing a downward revision of the Central Bank Rate (CBR) by 75.0 bps to 12.00% from 12.75% following their last meeting on 8th October 2024 will continue to stabilize the business climate	• In the short term, we expect the revenue collections to be affected as a result of the withdrawal of the Finance Bill 2024. We expect a revenue shortfall for the FY2024/2025 budget, and will likely result in Kenya missing the 4.3% fiscal deficit target this year. • The proposed raft of tax changes in the Finance Bill 2024 were geared towards expanding the tax base and raising revenues to meet the government's budget for the fiscal year 2024/2025 of Kshs 3.9 tn. The government's continued efforts to broaden the tax base will have been hampered. Among the key provisions in the Act included a removal of VAT exemption for several financial services, making them subject to the standard VAT rate of 16.0%, introduction of a new 2.5% tax on the value of motor vehicles, payable when issuing insurance cover, and taxing income from digital marketplaces or platforms and digital content monetization at 20.0% for non-residents and 5% for residents. As such, we expect the tax collections to be hindered in the long-term and thus impede the government's efforts to meet it revenue collection targets • 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.	**Negative**	**Negative**

Government Borrowing	• The government, as at 29th November 2024, was 136.3% ahead its prorated net domestic borrowing target of Kshs 172.8 bn having borrowed Kshs 408.4 bn of the total borrowing target of Kshs 408.4 bn. The government currently has domestic maturities worth Kshs 978.3 bn and will have to borrow Kshs 116.5 bn monthly to meet the upcoming domestic maturities and the budget deficit in the FY'2024/2025 • Total Borrowings as at the end of October 2024 amounted to Kshs 261.4 bn, equivalent to 16.6% of the revised estimates of Kshs 1,571.8 bn for FY'2024/2025 and are 49.9% of the prorated estimates of Kshs 523.9 bn. The cumulative domestic borrowing of Kshs 978.3 bn comprises of Net Domestic Borrowing Kshs 408.4 bn and Internal Debt Redemptions (Rollovers) Kshs 569.9 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 completed the seventh and eighth reviews of Kenya's Extended Fund Facility (EFF) and Extended Credit Facility (ECF) arrangements and the second review under the Resilience and Sustainability Facility (RSF) arrangement. Notably, this enabled immediate disbursement of USD 485.8 mn under the EFF/ECF arrangements and USD 120.3 mn under the Resilience Sustainability Facility (RSF). This latest disbursement brings the total amount received under the EFF/ECF Programme to USD 3.2 bn, USD 0.7 bn short of the USD 3.9 bn expected from the whole programme and a total of USD 180.5 bn received under the RSF programme.	• 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, and subsequent June maturity payment, the debt servicing costs are expected to remain high. This has led to Credit rating agencies such as Moody's Credit Rating Agency, S&P Global Rating and Fitch to downgrade Kenya's credit. Notably, Kenya's rating by Moody was at Caa1 for both local issuer and foreign currency issuer an indication of a high credit risk, while the outlook remained negative. In addition, Fitch Ratings revised Kenya's credit score, downgrading it to B- from a credit rating of B while also revising the outlook to stable, from a negative outlook affirmed on 16th February 2024. Additionally, S&P Global Ratings announced its revision of Kenya's long-term sovereign credit rating, downgrading it to B-, and a stable outlook from a credit rating of B and a negative outlook	**Negative**	**Negative**
Inflation	• Year on year (y/y) inflation rate for November 2024 increased marginally by 0.1% points to 2.8%, from the 2.7% recorded in October 2024. This was in line with our expectation of an increase. Our projection was mainly driven by the increase in electricity prices and a slight depreciation of the Kenya Shilling against the dollar. • Super Petrol, Diesel and Kerosene remaining unchanged from the prices announced for the previous period. Consequently, Super Petrol, Diesel and Kerosene will continue to retail at Kshs	• We expect inflation rates to remain within the CBK's target range of 2.5% - 7.5% supported by the current fiscal stance as CBR is expected to remain elevated in the short term, as the MPC continues to implement its scope on easing the CBR. Additionally, the recent appreciation of the Kenyan shilling against major currencies, which has so far appreciated by 17.4% on YTD against the dollar is expected to keep inflationary pressures in the country down as manufacturers get relief with the lower importation costs of inputs	**Positive**	**Positive**

	180.7, Kshs 168.1 and Kshs 151.4 per litre respectively. • Notably, November's overall headline inflation remained within the CBK's target range of 2.5% - 7.5% for the seventeenth consecutive month.			
Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has depreciated by marginally by 0.4% against the US Dollar to Kshs 129.7 as at 29th November, from Kshs 129.2 recorded on 8th October 2024 despite the improved foreign reserves which are currently above the statutory requirement • In addition, the Forex Reserves have increased significantly by 10.0% to USD 9.0 bn (equivalent to 4.6 months of import cover) as of 29th November 2024 from USD 8.6 bn (equivalent to 4.4 months of import cover) recorded on 8th October 2024. Notably, the forex reserves are above the statutory requirement of maintaining at least 4.0 months of import cover and 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 4,804.1 mn in the 12 months to October 2024, 15.3% higher than the USD 4,165.1 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the October 2024 diaspora remittances figures, North America remained the largest source of remittances to Kenya accounting for 56.7% in the period • Additionally, the shilling performance and strength is expected to be supported by the sufficient forex reserves currently at USD 9.0 bn (equivalent to 4.6 months of import cover) as of 29th October 2024 from USD 8.6 bn (equivalent to 4.4 months of import cover) recorded on 4th October 2024. Moreover, tourism inflow receipts which came in at USD 352.5 bn in 2023, a 31.5% increase from USD 268.1 bn inflow receipts recorded in 2022, and owing to tourist arrivals that improved by 7.2% in the 12 months to September 2024, from the arrivals recorded during a similar period in 2023	**Positive**	**Positive**
GDP Growth	• Kenyan's economy recorded a 4.6% growth in Q2'2024, slower than the 5.6% growth recorded in Q2'2023, pointing towards a slower economic growth. The performance was driven by; i. The positive growth recorded in all sectors except Mining and quarrying, with most sectors recording a decline compared to Q2'2023 with Accommodation & Food Services, Financial &Insurance and Construction Sectors recording the highest declines of 16.2%, 8.1%, and 5.6% points, respectively. Other sectors that recorded a contraction in growth rate, from what was recorded in Q2'2023 were Financial Services Indirectly Measured, Agriculture and Forestry and Real Estate sectors, of 4.0%, 3.0% and 2.1% points respectively;	• 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 October 2024 increased to 50.4, up from 49.7 in September, to move into the expansion zone, an indication of a improved business	**Neutral**	**Neutral**

	The slowed growth in the Agricultural Sector with Agriculture and Forestry recording a growth of 4.8% in Q2'2024. The performance was a decrease of 3.0% points, from the expansion of 7.8% recorded in Q2'2023. The slower growth recorded during the quarter was however supported by an increase in Sugarcane production by 81.5% to stand at 2,269.3 thousand metric tonnes, from the 1,250.3 thousand metric tonnes registered in Q2'2023	environment in the country. Likewise, according to CEO's survey- 2024 September report, optimism about growth prospects for the Kenyan business activity remained sustained attributed to the stable macroeconomic environment reflected in the low inflation rate and stability in the exchange rate, expectations of a decline in interest rates, continued strong performance of agriculture, resilience of the services sector, and improved global growth prospects.		
Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth declined to 0.4% in September 2024 from 1.3% in August 2024, mainly attributed to exchange rate valuation effects on foreign currency-denominated loans due to the appreciation of the Shilling. Notably, the 0.4% growth rate recorded in September 2024 is the lowest recorded figure in 22 years.	• 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 16.0% in the month of November effectively edging out majority of the corporate bonds currently in the trading in market • Additionally, banks have started to adjust their lending rates in line with the CBR rate which was cut to 12.00% in the October MPC meeting. This is expected to revitalize the private sector credit demand	**Negative**	**Negative**
Liquidity	• Liquidity levels in the money markets eased significantly, with the average interbank rate since the previous MPC meeting decreasing significantly by 0.4% points to 11.9% on 29th November 2024 from the 12.2% as of 11th October 2024, partly attributable to tax remittances that offset Government payments.	• We expect liquidity in the money markets to be supported by the domestic debt maturities that currently stand at Kshs 556.8 bn worth of T-bill maturities for FY'2024/2025.	**Positive**	**Positive**

Conclusion

Out of the seven factors that we track, three are positive, one is neutral and three are negative. Notably, most of the Central Banks of developed economies around the world have cut their rates with the aim of supporting economic activities and growth going forward.

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 cut the Central Bank Rate (CBR) to within a range of 11.50% - 11.75% with their decision mainly being supported by:

i. **Rate cuts by global giant economies**. In their last sitting on November 7th 2024, the US Federal Reserve announced their decision to cut its benchmark interest rate by 25.0 bps, to a range of 4.50%-4.75% from a range of 4.75%-5.00%. The European Central Bank announced a rate cut by 25 basis points to 3.25% in October from 3.50% earlier in September 2024. As such, we expect the MPC to follow through with this set precedence of loosening the monetary policy and cut the rate further,

ii. **The need to support the economy** by adopting a more accommodative policy that will ease financing activities and support private sector financing. Private sector credit growth came in at 0.4% in September 2024, the slowest in 22 years and a slowdown from 1.3% in August 2024. A rate cut would help unlock the private sector's potential, enabling it to act as a key driver of economic recovery and sustained growth. Additionally, the business environment remains subdued, hence a cut in the CBR will help spur economic growth, increase money supply and improve business activities in the country, and,

iii. **The continued stability of the Shilling against major currencies**, despite the October rate cut in the CBR gives room for a moderate cut without reversing the Shilling's gain. Since the last meeting, the Kenyan Shilling has depreciated marginally by 0.4% against the US Dollar to Kshs 129.7 as at 29th November 2024, from Kshs 129.2 recorded on 8th October 2024. The stability of the Shilling is expected to be supported by the improved foreign reserves which are currently at 4.6 months of import cover, above the statutory requirement of 4.0 months cover.