Cytonn Note on the 5th February 2025 Monetary Policy Committee (MPC) Meeting

The Monetary Policy Committee (MPC) is set to meet on Wednesday, 5th February 2025, 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 5th December 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 3.0% in December 2024, supported by the exchange rate stability, 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 October 2024, up from 3.7% in October 2023, and is projected at 4.0% of GDP in 2024 and 2025, 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 11.9% in the 12 months to October 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 2.1%, 16.8% and 73.5%. Imports increased by 7.9% in the twelve months to October 2024 compared to a similar period in 2023, mainly reflecting increases in intermediate and capital goods. Tourist arrivals improved by 14.9% in the twelve months to October 2024. Remittances increased by 15.3% to USD 4,804.1 mn in the twelve months to October 2024 from USD 4,166.6 mn in a similar period in 2023, and were 17.7% higher in the first 10 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 December 2024 amounted to Kshs 1,161.3 bn, equivalent to 44.1% of the revised estimates of Kshs 2,631.4 bn for FY'2024/2025 and is 88.3% of the prorated estimates of Kshs 1,315.7 bn. The total expenditure amounted to Kshs 1,714.1 bn, equivalent to 40.7% of the revised estimates of Kshs 4,207.9 bn, and is 81.5% of the prorated target expenditure estimates of Kshs 2,104.0 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 654.5 bn, equivalent to 50.0% of the revised estimates of Kshs 1,307.9 and 100.1% of the prorated estimates of Kshs 654.0 bn,

Below, we analyze the trends of the macro-economic indicators since the December 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 December 2024**	**Our Expectation Going forward**	**CBR Direction (December 2024)**	**Probable CBR Direction February 2025)**
Government Revenue Collection	• Total revenue collected as at the end of December 2024 amounted to Kshs 1,161.3 bn, equivalent to 44.1% of the revised estimates of Kshs 2,631.4 bn for FY'2024/2025 and is 88.3% of the prorated estimates of Kshs 1,315.7 bn. Cumulatively, tax revenues amounted to Kshs 1,047.1 bn, equivalent to 43.4% of the revised estimates of Kshs 2,475.1 bn and 86.8% of the prorated estimates of Kshs 1,237.5 bn • The government was unable to meet its prorated revenue targets for the sixth consecutive month of the FY'2024/2025, attaining 88.3% of the revenue targets in December 2024, mainly on the back of the tough economic situation exacerbated by the elevated high taxes in the country. 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 50.6 in December 2024, above the expansion zone, from the 50.9 recorded in November 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, having appreciated marginally by 0.1% against the dollar in the since the last meeting in December. Additionally, the stable 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 11.25% from 12.00% following their last meeting on 5th December 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 were hampered. • Despite this the government continues to employ a raft of measures to boost revenue collection through non-tax channels by streamlining its services to the public e.g. Citizen services, the Ministry of Lands and Immigration services and proposals to broaden the tax base through the Tax Laws Amendment Bill 2024. However, the upward revision of taxes comes at a time when the business environment remains subdued, underpinned by the increased taxation that has suppressed business production levels weighing down on the projected revenue performance. • 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 31st January 2025, was 126.9% ahead its prorated net domestic borrowing target of Kshs	• Kenya's rising debt sustainability remains a significant concern with the government's borrowing appetite		

	243.5 bn having borrowed Kshs 552.4 bn of the total borrowing target of Kshs 408.4 bn. The government currently has domestic maturities worth Kshs 687.2 bn and will have to borrow Kshs 110.6 bn monthly to meet the upcoming domestic maturities and the budget deficit in the FY'2024/2025 • Total Borrowings as at the end of December 2024 amounted to Kshs 570.0 bn, equivalent to 36.3% of the revised estimates of Kshs 1,571.8 bn for FY'2024/2025 and are 72.5% of the prorated estimates of Kshs 785.9 bn. The cumulative domestic borrowing of Kshs 1,200.2 bn comprises of Net Domestic Borrowing Kshs 551.0 bn and Internal Debt Redemptions (Rollovers) Kshs 649.2 bn • Kenya has continued to receive financing from the World Bank and other bilateral lenders such as the International Monetary Fund (IMF). In November 2024, 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.	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 2024, and subsequent June maturity payment, the debt servicing costs still remain high. This led to, Fitch Ratings revisingd 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. However, on 24th January 2025, the global ratings agency, Moody's announced its revision of Kenya's credit outlook to positive from negative, while maintaining the credit rating at Caa1, on the back of a likelihood of an ease in liquidity risks and improved debt affordability. The improved debt affordability is largely attributable to the reduction in domestic borrowing costs, evidenced by the sharp decline of yields for short-dated papers. Given the low inflation rates in the country, the stability of the exchange rate, and the ease in the monetary policy stance, domestic borrowing costs are expected to continue decreasing over the short-medium term.	**Negative**	**Negative**
Inflation	• Year on year (y/y) inflation rate for January 2025 increased marginally by 0.3% points to 3.3%, from the 3.0% recorded in December 2024. This was in line with our expectation of an increase. Our projection was mainly driven by the increase in fuel prices and the easing monetary policy stance. • Super Petrol, Diesel and Kerosene increased by Kshs 0.3, Kshs 2.0 and Kshs 3.0 respectively. Consequently, Super Petrol, Diesel and Kerosene is now retailing at Kshs 176.6, Kshs 167.1 and Kshs 151.4 per litre respectively, from Kshs 176.3, Kshs. 165.1 and Kshs 148.4 per litre respectively. • Notably, January's overall headline inflation remained within the CBK's	• We expect inflation rates to remain within the CBK's target range of 2.5% - 7.5% supported by the current fiscal stance, as the MPC continues to implement its scope on easing the CBR. Additionally, the recent stabilization of the Kenyan shilling against major currencies, which has so far appreciated by 0.1% 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**

	target range of 2.5% - 7.5% for the nineteenth consecutive month.			
Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has appreciated marginally by 0.1% against the US Dollar to Kshs 129.2 as at 31st January 2025, from Kshs 129.3 recorded on 5th December 2024 attributable to the improved foreign reserves which are currently above the statutory requirement • In addition, the Forex Reserves remain sufficient at USD 8.9 bn (equivalent to 4.5 months of import cover) as of 31st January 2025. Notably, the forex reserves are above the statutory requirement of maintaining at least 4.0 months of import cover	• We expect the Kenyan Shilling to be supported by Diaspora remittances standing at a cumulative USD 4,945.0 mn in 2024, 18.0% higher than the USD 4,190.0 mn recorded in 2023, which has continued to cushion the shilling against further depreciation. In 2024 diaspora remittances figures, North America remained the largest source of remittances to Kenya accounting for 51.0% in the period • Additionally, the shilling performance and strength is expected to be supported by the sufficient forex reserves currently at USD 8.9 bn (equivalent to 4.5 months of import cover) as of 31st January 2025. 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 14.9% in the 12 months to October 2024, from the arrivals recorded during a similar period in 2023	**Positive**	**Positive**
GDP Growth	• Kenyan's economy recorded a 4.0% growth in Q3'2024, slower than the 6.0% growth recorded in Q3'2023, 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 Q3'2023 with Accommodation and Food Services, Mining & Quarrying and Financial & Insurance Sectors recording the highest declines of 20.8%, 11.9% and 10.8% points, respectively. Other sectors that recorded a contraction in growth rate, from what was recorded in Q3'2023 were Construction, Electricity and Water Supply and Real Estate of 6.0%, 2.4% and 2.2% points respectively; ii. The slowed growth in the Agricultural Sector with Agriculture and Forestry recording a growth of 4.2% in Q3'2024. The performance was a decrease of 0.9% points, from the expansion of 5.1% recorded in Q3'2023. The slower growth recorded during the quarter was however supported by a significant	• We expect Kenya's GDP to show recovery in 2024 and 2025 at a faster pace, 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 stability 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 December 2024 decreased to 50.6, up from 50.9 in November, but still remaining in the expansion zone, an indication of a improved business environment in the country. Likewise, according to CEO's survey- 2024 November report, optimism about growth prospects for the Kenyan business activity remained sustained attributed to the stable macroeconomic environment reflected	**Neutral**	**Neutral**

	increase in Sugarcane production by 188.7% to stand at 2,523.5 thousand metric tonnes, from the 874.0 thousand metric tonnes registered in Q3'2023	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 the National Treasury indicates that growth in private sector credit declined by 1.1% in November 2024, compared to 13.2% growth in a similar period in 2023, mainly attributed to exchange rate valuation effects on foreign currency-denominated loans due to the appreciation of the Shilling and the lagged effects of the monetary policy tightening.	• 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, • Additionally, banks have started to adjust their lending rates in line with the CBR rate which was cut to 11.25%, in the December MPC meeting, with the weighted lending rate currently at 16.9%. 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 by 0.6% points to 11.2% as of 31st January 2025, from the 11.8% as of 6th December 2024, partly attributable to government payments that offset tax remittances	• We expect liquidity in the money markets to be supported by the domestic debt maturities that currently stand at Kshs 483.4 bn worth of T-bill maturities for FY'2024/2025.	**Positive**	**Positive**

Conclusion

Out of the seven factors that we track, three are positive, three are negative and one is neutral. 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) by 50.0 bps – 100.0 bps to within a range of 10.25% - 10.75% with their decision mainly being supported by:

i. **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 declining to 1.1% in November 2024, a further decline from 0.0% in October 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

ii. **Rate cuts by global giant economies**: The European Central Bank announced a rate cut by 25 bps to 2.75% on 30th January 2025, from 3.00% earlier in December 2024. Meanwhile, the US Federal Reserve decided to maintain their benchmark interest rate in their recent sitting on 29th January 2025 at 4.25%-4.50%, following the rate cut by 25.0 bps to a range of 4.25%-4.50% in their December 2024 meeting from a range of 4.50%-4.75% in their November 2024 meeting. As such, we expect the MPC to follow through with this set precedence of loosening the monetary policy and cut the rate further, and,

iii. **The continued stability of the Shilling against major currencies**: Despite the December rate cut in the CBR, this still gives room for a moderate cut without reversing the Shilling's stability. Since the last meeting, the Kenyan Shilling has appreciated marginally by 5.9 bps against the US Dollar to Kshs 129.2 as at 31st January 2024, from Kshs 129.3 recorded on 5th December 2024. The stability of the Shilling is expected to be supported by the stable foreign reserves which are currently at 4.5 months of import cover, above the statutory requirement of 4.0 months cover.