Cytonn Note on the 6th February 2024 Monetary Policy Committee (MPC) Meeting

The Monetary Policy Committee (MPC) is set to meet on Tuesday, 6th February 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 5th December 2023, 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 200bps to 12.5%, from 10.50% citing the need to contain the depreciation of the Kenyan Shilling as well as inflationary pressures which came in at 6.8% in November 2023, 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 10.50%, with our view having been informed by:

i. Inflation had remained within the bank's target of 2.5% -7.5% for the fifth 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 6.8% in the month of November 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 November 2023 PMI recording a drop to 45.8 from 46.2 recorded in October 2023, an indication of greater deterioration in the business environment. An additional hike in the CBR rate, in our view would curtail economic growth given the suppressed business environment,

The Monetary Policy Committee noted that the then ongoing implementation of the FY'2023/24 Government Budget, as well as the revised budget for the fiscal year, particularly the performance in tax revenue collection will continue to reinforce fiscal consolidation. Notably, the total revenue collected as at the end of December 2023 amounted to Kshs 1,092.1 bn, equivalent to 42.4% of the revised estimates of Kshs 2,576.8 bn for FY'2023/2024 and was 84.8% of the prorated estimates of Kshs 1,288.4 bn. Additionally, the Monetary Policy committee noted that the leading economic indicators pointed to a strong performance of the Kenyan economy mainly driven by the activities in services sector and recovery of the Agricultural sector. The committee further noted that goods exports had contracted having a year on year decline of 2.0% in the 12 months to October 2023. Notably, receipts from chemicals and manufactured exports increased by 5.1% and 13.9% respectively on the back improved prices due to demand from the regional market. Additionally, imports decreased by 14.9% in the 12 months to October 2023, compared to the 14.7% growth recorded in a similar period last year, due to drop of imports in all categories except food. Remittances in the 12 months to October 2023 amounted to USD 4,165.0 mn, representing a 4.2% gain compared to a similar period last year. However, the current account deficit was estimated at 3.7% of GDP in the 12 months to October 2023, and was projected at 4.1% of GDP in 2023 and 4.2% of GDP in 2024. Notably, private sector credit growth had increased marginally to 12.5% in October 2023 from 12.2% in September 2023. Strong credit growth was observed in manufacturing, transport and communication, trade, and consumer durables sectors which grew by 18.4%, 16.2%, 9.9% and 10.8% respectively, with the number of loan application and approval remaining strong, highlighting sustained demand and resilient economic activities

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 2023**	**Our Expectation Going forward**	**CBR Direction (December 2023)**	**Probable CBR Direction (February 2024)**

Government Revenue Collection	• The total revenue collected as at the end of December 2023 amounted to Kshs 1,092.1 bn, equivalent to 42.4% of the revised estimates of Kshs 2,576.8 bn for FY'2023/2024 and was 84.8% of the prorated estimates of Kshs 1,288.4 bn. Cumulatively, tax revenues amounted to Kshs 1,050.8 bn, equivalent to 42.1% of the revised estimates of Kshs 2,495.8 bn and 84.2% of the prorated estimates of Kshs 1,247.9 bn, • We note that the December 84.8% revenue attainment improved by 2.6% points from the performance in November where the government achieved 82.2% of the revenue targets, partly attributable to the improved business environment evidenced by the increase in the Purchasing Manager's Index which came in at 48.8, up from 45.8 in November 2023. However, the government's continued failure to achieve its prorated revenue targets for the sixth consecutive month in FY'2023/2024 reflects the challenges posed by the tough economic situation, depreciation of the Shilling, and a difficult business environment, despite signs of improvement. Additionally, inflation eased in December, coming in at 6.6%, from 6.8% in November 2023.	• In the short term, we expect the revenue collections to lag behind the prorated targets given the subdued business environment on the back of elevated inflationary pressures as a result of high fuel and electricity prices, coupled with the sustained depreciation of the shilling against the dollar which continue to put pressure on the economic environment • However, the government's continued efforts to broaden the tax base will 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, • Nevertheless, given the subdued general business environment which is underpinned by the depreciation of the Kenyan shilling, tightened liquidity in the money market, and elevated inflationary pressures, we expect the subdued business environment to weigh down the tax revenue given that consumers have cut back on their spending due to reduction in disposable income	**Neutral**	**Neutral**
Government Borrowing	• The government, as at 26th January 2024, was 34.0% behind its prorated borrowing target of Kshs 274.5 bn having borrowed Kshs 181.2 bn of the total borrowing target of Kshs 471.4 bn. The government has domestic maturities worth Kshs 634.6 bn and will have to borrow Kshs 179.8 bn monthly to meet the upcoming domestic maturities and the budget deficit in the FY'2023/2024 • Total Borrowings as at the end of December 2023 amounted to Kshs 348.2 bn, equivalent to 20.5% of the revised estimates of Kshs 1,701.7 bn for FY'2023/2024, and are 40.9% of the prorated estimates of Kshs 850.8 bn. The cumulative domestic borrowing of Kshs 851.9 bn comprises of Net	• 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. Additionally, the rising debt servicing with Kenya's external debt service costs is expected to rise sharply by 53.6% to USD 4.3 bn in FY'2023/2024 up from USD 2.8 bn that was spent on debt service in the previous year, FY'2022/2023 mainly due to the upcoming maturities such as the 10-year USD 2.0 bn (Kshs 321.6 bn) Eurobond maturing in June 2024. 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,	**Negative**	**Negative**

	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).	Kenya's latest rating by moody was at B3 for both local issuer and foreign currency issuer an indication of a high credit risk		
Inflation	• Year on year (y/y) inflation rate for December 2023 came in at 6.6%, an ease from 6.8% recorded in November 2023, while the month on month (m/m) inflation increased marginally by 0.4% points. The headline inflation for December 2023 was majorly driven by an increase in prices for Transport; housing, water, electricity, gas and other fuels; and Food and Non-alcoholic beverages; of 11.7%, 8.3% and 7.7% respectively. • Notably, the significant increase of Transport index by 11.7% year on year was mainly on the back of an increase in bus fare prices for some routes, despite a 2.3% and 1.0% decrease in the average prices of Super Petrol and Diesel respectively, in December. • Fuel prices remain elevated in the country, despite a decline in global prices mainly attributable to the high cost of fuel imports as a result of the sustained depreciation of the shilling against the US dollar, as well as the high taxation of petroleum products as provided in the finance Act 2023. • Notably, the December inflation eased marginally by 0.2% points to 6.6%, from 6.8% recorded in November before the MPC December Meeting. The headline	• 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 200 bps in December 2023 to 12.50%, after the rate remained constant at 10.50% for two consecutive meetings. However, the sustained depreciation of the Kenyan shilling against major currencies is also expected to underpin inflationary pressures in the country as manufacturers pass on the high cost of importation to consumers through hikes in consumer prices in order to maintain their margins	**Neutral**	**Neutral**

	inflation still remains within the Central Bank of Kenya target range of 2.5% - 7.5% .			
Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has depreciated by 4.9% against the US Dollar to Kshs 160.8 as at 25th January 2024, from Kshs 153.3 recorded on 5th December 2023 mainly attributable to persistent high dollar demand from importers, especially in the oil and energy sector • However, the Forex Reserves have increased by 4.1% to USD 7.0 bn (equivalent to 3.8 months of import cover) as of 26th January 2024 from USD 6.7 bn (equivalent to 3.6 months of import cover) recorded in 1st December 2023. 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 remain under significant pressure in the medium term as demand for the dollar continues to increase in the oil and energy sectors. However, the government-government dealing involving firms such as the Saudi Aramco (ARAMCO), Abu Dhabi National Oil Company (ADNOC) and Emirates National Oil Company (ENOC) to supply Kenya with diesel and super petrol on credit was extended to December 2024. As such we expect that this will lead to an ease in dollar demand by oil importers • Additionally, the shilling performance and strength is expected to be supported by the sufficient forex reserves currently at USD 7.0 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 have significantly increased by 82.9% to Kshs 268.1 bn in 2022, from Kshs 146.5 bn inflow receipts recorded in 2021. The tourism receipts are expected to increase evidenced by the increased number of visitor arrivals through the Jomo Kenyatta and Moi International airports, which has increased by 34.0% in August 2023 up from 235,982 recorded in July 2023	**Negative**	**Negative**
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	• 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, • However, the continued depreciation of the Kenya shilling has continued to weigh down on the business environment, by increasing the cost of imported inputs and adding the finance cost of the foreign currency denominated debts	**Neutral**	**Neutral**

	and Communication and Real 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.	• Notably, the country's PMI for the month of December 2023 increased for the first time in four months months to 48.8, up from 45.8 in November, to remain in the contractionary zone, an indication of a deteriorated 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 12.5% in October 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 tightened, with the average interbank rate since the previous MPC meeting increasing by 3.3% points to 13.7% as of 26th January 2024, from 10.4% recorded in 5th December 2023, partly attributable to tax remittances that offset Government payments	• We expect liquidity in the money markets to be supported by the high domestic debt maturities that currently stand at Kshs 469.5 bn worth of T-bill maturities and Kshs 165.1 bn worth of T-bond maturities for FY'2023/2024.	**Positive**	**Positive**

Conclusion

Out of the seven factors that we track, four are neutral, two are negatives and one is positive. 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 12.50% with their decision mainly being supported by:

i. The ease in y/y inflation in December 2023 to 6.6%, from 6.8% recorded in November 2023 marking the sixth consecutive month that inflation has fallen within the CBK target range of 2.5%-7.5%. However, the risk lies on the back of elevated fuel prices despite a decrease in global prices mainly on the back of the depreciating Shilling. As such, we expect the MPC to maintain the CBR as the current monetary stance still transmits in the economy,

ii. The need to support the Shilling from further depreciation as other Central Banks maintain high rates, is expected to remain a key factor in maintaining the CBR rate elevated. The Kenya Shilling has been on a free fall, having depreciated by 4.9% since the last MPC meeting on 5th December 2023, to close at Kshs 160.8 on 26th January 2024. The depreciation of the shilling is mainly on the back of a high demand for foreign currency by importers, the decline in foreign exchange reserves, which are currently below the statutory requirement, widening current account deficit, and global markets uncertainty. As such, a decrease in the CBR rate would possibly weaken the Shilling further by reducing its demand, and,

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 last four months remained below the 50.0 no-change threshold, with the December 2023 PMI coming in at 48.8, an indication of deterioration in the business environment. An additional hike in the CBR rate might curtail economic growth given the current macroeconomic and business environment, which cannot accommodate further hikes