Cytonn Note on the Monetary Policy Committee (MPC) Meeting for Sept 2020

The Monetary Policy Committee (MPC) is set to meet on Tuesday, 29th September 2020, 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 29th July 2020, the committee decided to reconvene in September 2020, while highlighting that they would remain ready to reconvene earlier if necessary, as they continue to closely monitor the impact of the policy measures have had so far. Additionally, the MPC maintained the CBR at 7.00% citing that the accommodative policy stance adopted in March, April and May 2020 sittings, which saw a cumulative 125bps cut, was having the intended effects on the economy. This was in line with our expectations as per our MPC Note with our view having being informed by:

i. Inflation was expected to remain stable and within the government's target range of 2.5% -7.5% on account of the re-opening of the Global markets which would address supply chain issues causing import prices to stabilize coupled with depressed global oil prices,
ii. Despite the high liquidity in the money market which came about as a result of the previous reduction in CRR ratio, we believed that additional rate cuts would not lead to a rise in Private sector growth given the reduced economic activities in Kenya's key sectors that has led to elevating credit risk which had resulted in reduced lending by banks, and,
iii. The currency has been depreciating, having lost 6.0% to USD since the beginning of the year attributable to high dollar demand from foreigners exiting the market as they direct their funds to safer havens. As such, further rate cut would put the shilling under pressure thus making Kenya a less attractive investment destination.

The Monetary Policy also noted that the current account deficit was projected to remain stable at 5.8% of GDP in 2020, from the previously recorded deficits of 5.0% and 4.3% of GDP in 2018 and 2019 respectively. Additionally, the MPC noted that there was a recovery in the month of May supported by improved agricultural output as well as government efforts, which continued to moderate the impact of the pandemic.

Below, we analyze the trends of the macro-economic indicators since the July 2020 MPC meeting, and how they are likely to affect the MPC decision on the direction of the CBR:

Indicators	Experience since the last MPC meeting in July 2020	Going forward	Probable CBR Direction (July)	Probable CBR Direction (September)
Government Revenue collections	• The National Treasury gazetted the statement of actual revenue collection and net exchequer issues in the month of July 2020. According to the release, ordinary revenue collection came in at Kshs 95.9 bn, 11.0% lower than the Kshs 107.8 bn recorded last year. The slump is largely attributable to the recent macroeconomic headwinds where a general slump in economic activity is expected	• Given the fiscal measures unveiled by the president to cushion businesses and individuals against the effects of the pandemic, we are pessimistic on the government's ability to meet its revenue collection targets in this current environment having considered the 11.0% decline in ordinary revenue collection in July 2020,	**Neutral**	**Neutral**
Government Borrowings	• The Government, as at 18th September 2020, was 103.3% ahead its current borrowing target having borrowed Kshs 228.1 bn against a prorated borrowing target of Kshs 112.2 bn and has to borrow on average, Kshs 91.5 bn monthly in FY'2020/2021 to meet its domestic borrowing target of Kshs 486.2	• There is increased demand for government debt due to increased liquidity in the money market hence leading to a decline in interest rates, • Due to the low ability for fiscal consolidation this financial year, we project a relatively higher fiscal deficit due to the lower revenue collection, which might put	**Neutral**	**Neutral**

	bn and has domestic maturities worth Kshs 840.4 bn	pressure on that the government at the tail end of the financial year		
Inflation	• Y/Y inflation for the month of August came in at 4.4%, while the m/m increased marginally by 0.2%. Y/Y inflation increased mainly driven by the 2.1% increase in the transport cost was mitigated by 1.0% decline in the Food and non-alcoholic foods prices	• We expect inflation to remain stable despite supply side disruption due to COVID-19, mainly supported by stable food prices due to favourable weather conditions. The recent re-opening of majority of the global markets will also address supply chain issues causing import prices to stabilize	**Positive**	**Positive**
Currency (USD/Kshs)	• The Kenya Shilling has depreciated by 0.6% against the US Dollar to Kshs 108.4, from Kshs 107.7 during the last meeting, attributable to: i. Increased dollar demand from importers as global economies continue easing movement restrictions. • Forex Reserves decreased to USD 9.3 bn (equivalent to 5.7 months of import cover) from USD 9.7 bn (equivalent to 5.9 months of import cover) since the last meeting, thereby providing adequate buffer to the shilling against foreign exchange shocks	• We maintain our view on the continued pressure on the Kenyan shilling, with the performance being on the back of: i. Increased dollar demand from merchandise importers as the easing of coronavirus restrictions jumpstart economic activities, thus boosting demand for hard currency, and, ii. Weaker inflows from foreign currency receipts which has led to dwindling foreign exchange reserves, evidenced by the decline to USD 9.3 bn, from USD 9.7 bn in July 2020,	**Negative**	**Negative**
GDP Growth	• Kenya's economy grew by 4.9% in Q1'2020, a decline from the 5.5% recorded in Q1'2019, which was due to: i. A 9.3% slowdown in the Accommodation and Food Services Sector compared with the growth of 11.0% recorded in Q1'2019, The decline was however mitigated by; ii. The Agricultural sector which recorded a slightly faster growth of 4.9%, compared to 4.7% seen in Q1'2019, and, iii. Faster growth in the: Mining and Quarrying, Education, Health and Agriculture and Forestry sectors which grew by 9.5%, 5.3%, 5.8% and 4.9% in Q1'2020, from 1.4%, 4.3%, 5.4% and 4.7%, respectively, recorded in Q1'2019;	• We expect subdued performance for the rest of the year mostly informed by the slower business activity experienced during the first half of the year in the country evidenced by the PMI's decline to lows of 34.8 recorded in April, despite it improving to 53.0 as at August 2020, and, • The Parliamentary Budget Office in September 2020 revised its growth outlook to a range of 1.0% - 2.0%, from an earlier forecast of (1.5%) to 1.0% in April 2020. Based on the impacts witnessed so far we lowered the GDP growth estimates to 1.4%-1.8% for the year 2020 depending on the severity of the outbreak and economic implications for Kenya.	**Negative**	**Negative**
Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth recorded a decline in the 12 months to June 2020 to 7.6% from 8.1% recorded in May 2020, but similar to the 5-year average of 7.6%	• The tough economic conditions brought about by the pandemic have increased cash constraints by businesses as well as households with most businesses struggling to keep afloat due to subdued revenues. Consequently, this led to high Gross Non-Performing Loans in Q1'2020 of 11.3%, from 10.4% recorded in Q1'2019 • The effects of the coronavirus pandemic are expected to negatively affect the	**Neutral**	**Neutral**

		financial sector. We expect to see increased caution on lending especially to businesses that rely on imports hence inhibiting private credit sector growth due to the high risk of credit default, with the possibility of heightened Non Performing Loans if the pandemic is to continue		
Banking Sector Liquidity	• Liquidity levels in the money markets decreased with the average interbank rate on 18th September 2020 coming in at 2.9% from the 2.3% during the last meeting on 25th June, supported by government payments,	• Liquidity is expected to remain favorable due to: i. High domestic debt maturities in 2020 that currently stand at Kshs 717.8 bn worth of T-bill maturities and Kshs 122.6 bn worth of T-bond maturities, ii. Low Cash Reserve Ratio (CRR) currently at 4.25% from 5.25% previously. Despite the reduction of the CRR, lending to the private sector has remained muted	**Neutral**	**Positive**

Conclusion

Of the factors that we track, three are neutral, two are negative and two is positive, with the only change being the "positive" for banking sector liquidity, between July 2020 and September 2020.

The main goal of the monetary policy is to maintain price stability and support economic growth by controlling money supply in the economy. We expect the MPC to maintain the Central Bank Rate (CBR) at 7.00%, with their decision mainly being supported by:

i. The high liquidity in the money markets given that the previous reduction in CRR ratio did not result in a significant increase in lending to the private sector. We believe that additional rate cuts will not lead to a rise in Private sector growth given the reduced economic activity in Kenya's key sectors and elevating credit risk resulting to reduced lending by banks,
ii. Additional rate cuts would lead to a further depreciation of the Shilling thus reducing Kenya's attractiveness as an investment destination, and,
iii. Inflation is expected to remain stable and within the government's target range of 2.5% -7.5% on account of the reopening of the Global markets which have addressed the earlier on supply chain issues causing import prices to stabilize coupled with stable food prices as a result of the favorable weather conditions. Given that one of the main goals of monetary policy is to ensure price stability, we believe that the stable inflation rate will not exert pressure on the MPC to implement inflationary control.

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