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

The Monetary Policy Committee (MPC) is set to meet on Tuesday, 6th August 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 June 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 maintain the CBR at 13.0% citing the that its previous interventions successfully curbed inflation, mitigated exchange rate pressures, and stabilized inflationary expectations which came in at 4.6% in June 2024, remaining within the CBK target range of 2.5%-7.5%. This was in line with our expectation for the MPC to retain the CBR rate at 13.0%, with our view having been informed by:

i. Inflation had remained within the bank's target of 2.5% -7.5% for the eleventh 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 5.1% in the month of May 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 has averaged above the 50.0 no-change threshold, with the May 2024 PMI recording an increase to 51.8 from 50.1 recorded in April 2024, an indication of slowly improving business environment. An additional hike in the CBR rate, in our view would curtail economic growth given the improving business environment,

The Monetary Policy Committee noted that the current account deficit is estimated at 4.1% of GDP in April 2024, down from 4.8% in 2023, and is projected at 4.0% of GDP in 2024, reflecting the expected recovery in exports, resilient remittances, and expected rebound in agricultural exports. Additionally, the Monetary Policy committee noted that Goods exports increased by 2.9% in the twelve months to April 2024 compared to a similar period in 2023. The increase in exports in 2024 was across several categories, including tea and vegetable & fruits and agricultural re-exports, which saw respective increases of 5.6%, 10.5% and 38.1%. Imports declined by 7.7% in the twelve months to April 2024 compared to the same period in 2023, reflecting lower imports across all categories, except for machinery and transport equipment. Tourist arrivals improved by 27.2% in the twelve months to March 2024 compared to a similar period in 2023, and were 22.0% higher in March 2024 compared to March 2023. Remittances increased by 11.9% to USD 4,457 million in the twelve months to April 2024 from USD 3,985 million in a similar period in 2023.

Additionally, The Committee noted the ongoing implementation of the FY2023/24 Government Budget as well as the proposed FY2024/25 Budget, which are expected to continue to reinforce fiscal consolidation. Notably, total revenue collected as at the end of June 2024 amounted Kshs 2,293.0 bn, equivalent to 93.2% of the revised estimates of Kshs 2,461.0 bn for FY'2023/2024. The total expenditure amounted to Kshs 3,796.1 bn, equivalent to 89.0% of the revised estimates of Kshs 4,263.9 bn. Additionally, the net disbursements to recurrent expenditures came in at Kshs 1,360.1 bn, equivalent to 94.8% of the revised estimates of Kshs 1,435.0.

Below, we analyze the trends of the macro-economic indicators since the June 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 June 2024	Our Expectation Going forward	CBR Direction (June 2024)	Probable CBR Direction (August 2024)

Government Revenue Collection	• Total revenue collected as at the end of June 2024 amounted Kshs 2,293.0 bn, equivalent to 93.2% of the revised estimates of Kshs 2,461.0 bn for FY'2023/2024. Cumulatively, tax revenues amounted to Kshs 2,161.1 bn, equivalent to 96.0% of the revised estimates of Kshs 2,251.9 bn. • The government has been unable to meet its prorated revenue targets for all the months of the FY'2023/2024, attaining 93.2% of the revenue targets in June 2024, mainly on the back of the tough economic situation despite the easing inflationary pressures that despite decreasing by 0.3% points in July to 4.3% from the 4.6% recorded in June, cost of living remains elevated in the country, which continues to impede revenue collection, further exacerbating the deteriorating business environment with the PMI coming in at 47.2 in June from the 51.8 recorded in May 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 appreciation of the Shilling, which gained by 15.6% against the dollar on a YTD basis despite the 0.3% depreciation recorded in July and a further ease in inflationary pressures in the country.	• 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 4.7% 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.	**Neutral**	**Negative**
Government Borrowing	• The government, as at 31st July 2024, was 20.8% ahead its prorated borrowing target of Kshs 39.8 bn having borrowed Kshs 33.0 bn of the total borrowing target of Kshs 429.0 bn. The government has domestic maturities worth Kshs 944.3 bn and will have to borrow Kshs 121.5 bn monthly to meet the upcoming domestic maturities and the budget deficit in the FY'2024/2025 • Total Borrowings as at the end of June 2024 amounted to Kshs 1,500.7 bn, equivalent to 83.4% of the revised estimates of Kshs 1,799.7 bn for FY'2023/2024. The cumulative domestic borrowing of Kshs 1,052.1 bn comprised of Net Domestic Borrowing Kshs 622.4 bn and Internal Debt Redemptions (Rollovers) Kshs 389.7 bn for FY'2024/25.	• 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 their outlook of Kenya. Notably, Kenya's latest rating by Moody was at Caa1 for both local issuer and foreign currency issuer an indication of a high credit risk, white the outlook remained negative. In addition, S&P announced that it would decide, on August 23rd	**Negative**	**Negative**

	• 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 reached a staff-level agreement om a set of comprehensive policies and reforms needed to complete the complete the seventh 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, upon completion of the seventh review of Kenya's economic program under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF) arrangements, the total IMF financial commitment during the duration of the EFF/ECF program to about USD 3.60 bn (KES 466.1 bn). In addition, the completion of the second Review under the Resilience and Sustainability Facility (RSF), approved on July 17, 2023, would unlock USD 120 mn (KES 15.5 bn).	2024, on whether to cut Kenya's B credit score by a notch to B- or retain it and keep it on a downgrade warning by maintaining a negative outlook.		
Inflation	• Year on year (y/y) inflation rate for July 2024 declined by 0.3% points to 4.3%, from the 4.6% recorded in June 2024. The headline inflation in July 2024 was majorly driven by increase in prices of commodities in the following categories; Food & Non-alcoholic beverages, Transport, and housing, water, electricity, gas and other fuels by 5.6%, 4.0% and 3.9%, respectively. • Notably, the m/m increase in transport Index was recorded despite the decline in the prices of a litre of petrol and diesel by 0.5% and 0.8%, respectively. • Super Petrol, Diesel and Kerosene decreased by Kshs 1.0, Kshs 1.5 and Kshs 1.3 each respectively, and will retail at Kshs 188.9, Kshs. 171.6 and Kshs. 161.8 per litre respectively from the June 2024 prices of Kshs 189.8, Kshs. 173.1 and Kshs. 163.1 respectively. • Notably, July's overall headline inflation was on the decline for two consecutive months, and remained within the Central Bank of Kenya (CBK) target range of 2.5% to 7.5% for the thirteenth consecutive month.	• We expect inflation rates to remain 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	**Positive**	**Positive**

Currency (USD/Kshs)	• Since the last meeting, the Kenyan Shilling has appreciated by 0.8% against the US Dollar to Kshs 129.9 as at 31st July 2024, from Kshs 131.0 recorded on 5th June 2024 mainly attributable to eliminated credit risk from the Eurobond buyback • In addition, the Forex Reserves have increased by 4.7% to USD 7.3 bn (equivalent to 3.8 months of import cover) as of 26th July 2024 from USD 7.0 bn (equivalent to 3.6 months of import cover) recorded in 7th June 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 4,535.0 mn in the 12 months to June 2024, 12.9% higher than the USD 4,017.0 mn recorded over the same period in 2023, which has continued to cushion the shilling against further depreciation. In the June 2024 diaspora remittances figures, the US remained the largest source of remittances to Kenya accounting for 54.0% in the period. • Additionally, the shilling performance and strength is expected to be supported by the sufficient forex reserves currently at USD 7.3 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 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 27.2% to 2.1 mn in the 12 months to March 2024, from 1.6 mn recorded during a similar period in 2023.	**Positive**	**Positive**
GDP Growth	• Kenyan's economy recorded a 5.0% growth in Q1'2024, slower than the 5.5% growth recorded in Q1'2023, 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 Q1'2023 with Accommodation & Food Services, Mining & Quarrying and Construction Sectors recording the highest declines of 19.1%, 3.8%, and 2.9% points, respectively. Other sectors that recorded a contraction in growth rate, from what was recorded in Q1'2023 were Transport and Storage, Other Services and Public Administration sectors, of 2.8%, 2.1% and 1.8% points respectively; ii. The slowed of Agricultural Sector with Agriculture and Forestry recorded a growth of 6.1% in Q1'2024. The performance was a decrease of 0.3% points, from the expansion of 6.4% recorded in Q1'2023. The slower growth recorded during the quarter was mainly attributable to decline in exports of coffee, fruit and cut	• 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 June 2024 decreased to 47.2, down from 51.8 in May, to move into the contraction zone, an indication of a deteriorated business environment in the country. Likewise, according to CEO's survey-November 2023 report, the growth prospects for the Kenyan economy are moderate, but easing inflation, stability of the Shilling, and good weather prospects are expected to continue to support growth.	**Neutral**	**Neutral**

	flowers. Coffee exports declined by 13.8% to stand at 9,722.3 metric tonnes in Q1'2024 from the 11,284.9 metric tonnes recorded in Q1'2023.			
Private Sector Credit Growth	• The latest data from CBK indicates that private sector credit growth declined to 6.6% in April from 7.9% recorded in March 2024, attributable to the impact of monetary policy tightening in addition to the effect of exchange rate appreciation on foreign currency. Notably, the 6.6% growth rate recorded in April 2024 is the lowest recorded figure in 29 months.	• 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 17.4% in the month of July 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 maintained at 13.0% in June MPC meeting. This is expected to slow down the private sector credit demand	**Neutral**	**Positive**
Liquidity	• Liquidity levels in the money markets eased slightly, with the average interbank rate since the previous MPC meeting decreasing slightly by 2.8 bps to remain relatively unchanged at 13.2% as of 31st July 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 634.0 bn worth of T-bill maturities for FY'2024/2025.	**Positive**	**Positive**

Conclusion

Out of the seven factors that we track, four are positive, one is neutral and two are 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 cut the Central Bank Rate (CBR) to the range of 12.00%-12.50% with their decision mainly being supported by:

i. The decrease in y/y inflation in July 2024 to 4.3%, from 4.6% recorded in June 2024, marking the thirteenth consecutive month that inflation has fallen within the CBK target range of 2.5%-7.5%. Despite the risk posed by reduced but still elevated fuel prices, mainly due to high taxes, the overall inflation trend supports a rate cut to stimulate economic growth,
ii. The recent appreciation of the Shilling and the need to stabilize it from volatility, as other Central Banks maintain high rates. Since the last meeting, the Kenyan Shilling has appreciated by 0.8% against the US Dollar to Kshs 129.9 as of 31st July 2024, from Kshs 130.5 recorded on 5th June 2024. This appreciation is mainly attributable to the eliminated credit risk from the Eurobond buyback and increased dollar supply in the market. A moderate cut in the CBR rate is expected to support this stability without reversing the Shilling’s gains,
iii. The need to support the economy by adopting an accommodative policy that will ease financing activities. The Purchasing Managers Index (PMI) has come in below the 50.0 threshold, with the June 2024 PMI at 47.2, indicating that the business environment is in the contraction zone. A rate cut would help stimulate economic growth by making borrowing cheaper and encouraging investment and spending,
iv. The global monetary policy environment. Many central banks worldwide including the Bank of England have either paused or reduced their rates to support their economies. Aligning Kenya's monetary policy with global trends could help maintain the country's competitiveness, attract foreign investment, and ensure that local economic conditions remain favorable in a global context.

Disclaimer: The views expressed in this publication are those of the writers where particulars are not warranted. This publication, which is in compliance with Section 2 of the Capital Markets Authority Act Cap 485A, is meant for general information only and is not a warranty, representation, advice, or solicitation of any nature. Readers are advised in all circumstances to seek the advice of a registered investment advisor.