Cytonn Note on the Kenya Macroeconomic FY'2021 Review

In 2021, the Kenyan economy rebounded, with the GDP for the first half of the year being 5.4%, following the 10.1% growth recorded in Q2'2021 and the 0.7% growth recorded in Q1'2021. The recovery was largely driven by growth in the transport sector and the accommodation and food sector which recorded growths of 16.9% and 9.1%, respectively, in Q2'2021, compared to the contraction of 16.8% and 56.6%, in Q2'2020. According to the recently released Q3'2021 GDP Report by the Kenya National Bureau of Statistics (KNBS), the economy recorded a 9.9% growth in Q3'2021, compared to the 2.1% contraction recorded in Q3'2020. The growth is attributed to the gradual easing of COVID-19 containment measures such as the travel restrictions and the lift of the dawn to dusk curfew that was put in place since March 2020.

In 2021, the Kenyan economy is projected to grow at an average of 5.8% supported by the continued recovery in the accommodation and food sectors, the easing of the COVID-19 restrictions and the rollout of the vaccine. However, the key challenge remains the COVID-19 pandemic given the emergence of new variants such as the Omicron variant. The table below shows the projections by various organizations;

No.	Organization	2021 Projections
1	International Monetary Fund	7.6%
2	National Treasury	6.4%
3	Cytonn Investments Management PLC	5.7%
4	World Bank	5.0%
5	S&P Global	4.4%
Average		**5.8%**
Median of Growth Estimates		**5.7%**

Source: Cytonn Research, 2021

The table below shows the macro-economic indicators that we track, indicating our expectations for each variable at the beginning of 2021 versus the experience;

Macroeconomic Indicators 2021 Review				
Macro-Economic Indicators	**2021 Expectations at Beginning of Year**	**Outlook - Beginning of Year**	**2021 Experience**	**Effect**
Government Borrowing	• We expected the government to come under pressure to borrow so as to meet its domestic and foreign borrowing targets for FY'2020/21, and with the expectations of KRA not achieving the revenue target, • We expected banks to increase their credit accessibility and admit riskier borrowers including SMEs and individuals due to interest rate cap repeal, which would see a reduction in subscription rates for government securities.	**Negative**	• The government is 5.9% ahead of its prorated borrowing target of Kshs 341.9 bn having borrowed Kshs 362.1 bn, • Kenya's debt to GDP ratio came in at an estimated 71.7% as of June 2021, 21.7% points above the IMF recommended threshold of 50.0% for developing nations, • In our view, we anticipate that the revenue collected will not be enough to plug in Government's deficit and we therefore expect the government to continue borrowing aggressively to plug in the high fiscal deficit which is projected at 7.5% of GDP for the FY'2021/22 budget.	**Negative**

Exchange Rate	• Currency was projected to range between Kshs 107.0 and Kshs 110.0 against the USD in 2021, with continued support from the CBK in the short term through its sufficient reserves which stood at USD 7.7 bn (equivalent to 4.7-months of import cover) as at 7th Jan 2021, 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.	**Neutral**	• The Kenya Shilling depreciated by 3.6% against the US Dollar to close at Kshs 113.1 in 2021, compared to Kshs 109.2 at the end of 2020, • Although forex reserves remain ample to support the Kenyan shilling, we note that the current pressure on the shilling is a cause of concern and the continuous depreciation of the shilling caused by increasing dollar demand from energy and merchandise importers as global fuel prices and costs of imports continue to outweigh the dollar inflows as some of the sectors like tourism are yet to fully recover.	**Negative**
Interest Rates	• Given the accommodative policy stance utilized in 2020, we expected the same to be maintained through 2021 with the intention of continued support to the economy from the adverse effects of the pandemic. There is however the risk of the yield curve adjusting upwards.	**Neutral**	• Interest rates remained stable during the year, • Despite the accommodative stance adopted by the Monetary Policy Committee, yields on government securities are expected to increase mainly driven by increased borrowing appetite by the government coupled with investors' hunt for higher yields.	**Neutral**
Inflation	• Inflation was expected to average 5.2%, within the government target range of 2.5%- 7.5%.	**Positive**	• Having averaged 6.1% in 2021, we project inflation to remain within the government's set range of 2.5% - 7.5%, • However, concerns remain high on the widening trade deficit as global fuel prices continue to rise due to supply bottlenecks.	**Neutral**
GDP	GDP growth was projected to come in at a range of 3.9% - 4.1%, lower than the 5-year historical average of 5.7%.	**Neutral**	• With the economy having grown in the first half of 2021, the economy is projected to continue recovering with the GDP growth for 2021 projected at 5.8%.	**Neutral**
Investor Sentiment	• We expected 2021 to register improved foreign, mainly supported by long term investors who enter the market looking to take advantage of the current low/cheap valuations in select sections of the market.	**Positive**	• With economic recovery and companies having positive valuations we project an improvement in investor sentiment.	**Positive**
Security	• We expected security to be maintained in 2021, with concern about the political environment which we expect to heat up gradually as we edge closer to the 2022 General Election.	**Neutral**	• The security remained sound during the year despite the approaching general elections to be held on 9th August 2022, • Major discussions revolved around the containment of the pandemic, reopening of the economy and Bridging Bridges initiative referendum.	**Neutral**

Since the beginning of the year, the notable changes we have seen out of the seven metrics that we track, fall under Exchange rates and Inflation. Exchange rates changed from neutral to negative while Inflation rate changed from positive to neutral. In conclusion, macroeconomic fundamentals showed mixed performances during the year but we expect a continued recovery in 2022 supported by the improving business conditions in the country. This will, however, be highly dependent on how well the government can handle the emerging COVID-19 Omicron variant and the upcoming national elections.

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